MISSISSIPPI LAW JOURNAL

TRIBUTE TO GUTHRIE T. ABBOTT

Robert C. Khayat
Robert A. Weems
John Corlew
Robert Galloway

TRIBUTE TO MICHAEL FEATHERSTONE

David W. Case
Tom R. Mason
W. Steve Bozeman

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Employers' Liability for Workplace Violence
Amy D. Whitten
Deanne M. Mosley

Against Cooperative Federalism
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Post-Production Charges to Royalty Interests:
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The Absent Settling Tortfeasor and the Immune Employer

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Constitutional Law—Fourth Amendment—Primary Purpose
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VOLUME 70 **WINTER 2000** **NUMBER 2**

RECENT DECISIONS
OF THE MISSISSIPPI SUPREME COURT AND
THE MISSISSIPPI COURT OF APPEALS

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"Gladly would he learn and gladly teach" was first said of Chaucer's Scholar, but at the University of Mississippi School of Law, that phrase aptly describes both Professor Abbott and Professor Featherstone.

In recognition of their matchless service and devotion to the students of this law school, it is with great pride and deep appreciation that we, the members of the *Mississippi Law Journal*, dedicate this volume to Professor Guthrie T. Abbott and Professor Michael Featherstone.

TRIBUTE TO GUTHRIE T. ABBOTT

Robert C. Khayat[*]

The wonderful Christian writer Frederick Beuchner concludes that the meaning of *vocare* is the work a person is called to by God. He further declares that we know we have found our life's work when 1) we are involved in the work we need most to do, and 2) it is the work the world most needs us to do.

When Guff Abbott joined the faculty of our Law School, his professional needs intersected with the work our profession and society most needed him to do. Professor Abbott truly found his *vocare*.

With the multiple gifts of intellect, wit, curiosity and compassion, Guff Abbott has challenged, amused, inspired and befriended thousands of law students and practicing attorneys. Class rosters, outstanding professor awards, presidency of the Mississippi Bar and the remarkable Abbott-Weems Mississippi Law Seminar provide tangible evidence of the success of Guff's career. His professional achievements unequivocally demonstrate that he has earned membership in the exclusive fraternity that includes L.Q.C. Lamar, Myres McDougal, Bob Farley, John Fox, Hector Cunie and Parham Williams. If we created a University of Mississippi Law Professor Hall of Fame, Guff would be a charter member.

Beyond the tangible contributions he has made to legal education and the legal profession, Guff's personal journey has brought great value to our law school, the larger University community, Oxford and the State of Mississippi. Active participation in his church, as chair or as a member of numerous University committees and dedicated voluntary service in the Oxford community have enabled him to enrich

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[*] Chancellor, University of Mississippi.

the lives of all who know him.

The true measure of a life is found in relationships with family, friends and colleagues. In his thoughtful, gentle, humorous manner, Guff has established and nurtured relationships that span several generations – from frightened first year law students to the elder-statesmen of the legal profession.

Professor Abbott's extraordinary gifts and dedicated service have enabled him to reach the zenith of his profession by realizing his *vocare*.

TRIBUTE TO GUTHRIE T. ABBOTT

Robert A. Weems[*]

Guff Abbott's retirement from the University of Mississippi School of Law brings to an end one of the most outstanding tenures in the 150 year history of the school. He has been a truly outstanding teacher. His teaching awards—Teacher of the Year in the law school four times and University of Mississippi Teacher of the Year—are proof of this, but even more so is the testimony of thousands of students, testimony given in glowing teacher evaluations and in personal comments for thirty years. His writings, most of which have been published in his beloved *Mississippi Law Journal*, have been of great and lasting benefit to the bench and bar of this state.

His service to the law school and to the University has been unceasing. He has served on countless committees, chaired many, been faculty advisor to the Mississippi Law Journal and has served as interim dean. The intelligence and judgment that he has brought to these responsibilities, and to the law school in general, have been invaluable.

His service to the legal profession through his work with the Mississippi Bar is virtually without parallel for a member of the law school faculty. He served for many years on the very important Rules Committee, and was for a time its chair. He served as President of the Bar in 1999, only the second member of this faculty to do so in the history of the Bar.

All of the above is a matter of record, and what a record. But the reality in Guff's case is much more than the record. The reality is that thousands of students who have come through this law school in the past thirty years are better people and better lawyers because of Guff. The law school is a

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[*] Professor, University of Mississippi School of Law.

better place because of him, and so is the university and the legal profession. To say that he will be missed is the grossest of understatements.

TRIBUTE TO GUTHRIE T. ABBOTT

John Corlew[*]

In 1962 Guff Abbott and I were roommates at the Ole Miss Sigma Nu house. I recall his telephone call in 1968 when he had made the decision not to serve as law clerk to a federal judge, but to return to the law school to teach. In later years, Guff would turn down more than one opportunity to serve as a federal judge himself.

Guff Abbott has always had a clear vision of what he wanted to do – unclouded by the influence of the stereotypical lawyer ambition for financial wealth, power or personal fame. He loves to teach, and dedicated himself to that calling with an excellence that has enriched the lives of hundreds of law students and lawyers, inside and outside the State of Mississippi.

Guff is one of those rare individuals who never changes. He is as unassuming, easy-going and affable today as he was 40 years ago. Blessed with a brilliant mind, he elected to utilize it to educate and elevate law students who took his signature course offerings in real property and Mississippi civil procedure, and who otherwise came to know him outside the classroom. On four occasions those students collectively named him as the law school's outstanding professor. Individually I cannot recall a law school graduate who didn't identify him as an outstanding teacher and profound influence in his or her law school experience.

Despite his unassuming demeanor, the magnitude of Professor Abbott's contribution to legal education and the legal profession in Mississippi is remarkable. When the occasion demanded it, he served as Acting Dean of the Law School in 1985-1987. But his love of teaching caused him to refuse consideration for such full-time administrative responsibilities.

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[*] Member of Watkins & Eager PLLC, Jackson, Mississippi

His stature in the profession caused him to be selected to serve in 1998-99 as President of The Mississippi State Bar, the only law professor to be so honored in the State Bar's 70-year history.

With continuing legal education and the advent of hundreds of CLE seminars, his annual seminar, "Summary of Recent Mississippi Law," with Professor Robert Weems, has been far and away the favorite of Mississippi lawyers since its inception in 1984. The Mississippi Law Journal has benefited from over 25 years of his service as faculty advisor. His service has included chairing the Mississippi Supreme Court Advisory Committee on Rules of Civil Practice and Procedure.

Guff Abbott has quietly been a giant in legal education and the legal profession in the State of Mississippi. He has been an example of excellence and commitment to the highest ideals of the legal profession for all of us. We are grateful for his unselfish service and wish him and his delightful wife Patsy the very best as he gives up full-time teaching responsibilities.

TRIBUTE TO GUTHRIE T. ABBOTT

Robert Galloway[*]

I recently had the privilege of saying a few words in memory of a deceased Justice of the Mississippi Supreme Court who I knew well and had practiced before when he was a trial judge as well as a Supreme Court Justice. As I was driving to Jackson for the memorial service, I thought how unfortunate it is that so many good words, though well deserved, are recited about the departed and so relatively few about those still among us. What a pleasure it is, then, to participate in this dedication to Guthrie T. "Guff" Abbott while he is still very much a part of our lives.

I have known Guff Abbott since we were freshmen and fraternity pledges together in the Fall of 1960, over forty years ago. We were at Ole Miss together seven years, then practiced law together for a year or two before he returned to teach at the law school. In undergraduate school I had a car when Guff didn't; the best use it was ever put to was loaning it to Guff so he could take out the lovely, vivacious Patsy Munn, his wife of thirty-five years. I will never be able to repay Guff and Patsy for the innumerable meals I ate at their apartment during law school alone, much less the many weekends my family and I have spent at the "Abbott Motel" during football season and on other occasions. Many of you no doubt have similarly experienced Guff and Patsy's generous hospitality.

Most of the readers of this memoir will know Guff Abbott from his thirty year career at the law school, during which he has been recognized as law school teacher of the year and University teacher of the year, his wonderful annual seminar with Bob Weems, his scholarly law journal articles and his mentorship of the Mississippi Law Journal, or his many activities with The Mississippi Bar, which he recently served

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[*] Member, Gulf Coast Office, Butler, Snow, O'Mara, Stevens and Cannada. Mr. Galloway received his J.D. from the University of Mississippi in 1967.

as President. A born teacher, he has imparted knowledge to thousands with clarity and wit. A true leader, he has inspired many to be better lawyers and more involved citizens. But the impact Guff has made is better recognized outside the classroom, outside the Bar committee meeting.

One of the joys of a football weekend with the Abbotts is walking across the Grove with Guff and seeing his many friends, especially his many present and former students, greet him in a special way. No politician has more hands extended; no athletic hero lights up more eyes or broadens more smiles. They feel important when he stops to talk to them, as he always does; I feel important to be in his company on those occasions. I believe that's because Guff always sees the good qualities in people, the glass more than half full; he embodies and exudes the yang of life and is able to encourage and enhance those attributes in those around him.

For what he has taught us, about law and life, for what he has encouraged and helped us to achieve, it is indeed appropriate that we dedicate to Guff Abbott this issue of the Mississippi Law Journal. We applaud his accomplishments, wish him well in future endeavors and look forward to many more years of friendship.

TRIBUTE TO "IRON MIKE" FEATHERSTONE

David W. Case[*]

At the conclusion of the 2000-01 academic year, Professor Michael Featherstone will retire from the University of Mississippi School of Law following twenty-nine years of dedicated service. The *Mississippi Law Journal*'s request that I write this brief tribute in honor of this important occasion affords me a rare dual privilege. I am able to pay tribute to a favorite former law professor and honor my father-in-law at the same time. Fourteen years ago, between our respective second and third years as law students at Ole Miss, Mike's daughter Catherine and I were married. Thus, of Professor Featherstone's many former students, I have a unique perspective regarding his lengthy and distinguished career.

When I began law school in 1985, Professor Featherstone already had been teaching for well over a decade. Students called him "Iron Mike" (outside of class, of course), a nickname bestowed by his very first students at Ole Miss and subsequently passed on from class to succeeding class as part of the law school's abundant oral tradition. The nickname reflected respect (and, for some, significant angst) for Professor Featherstone's reputation as a strict grader and a forceful and at times intimidating lecturer, especially in first year courses. Especially during that stressful first year, many of my fellow students who had Professor Featherstone for Property I and II seemed certain of the nickname's

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[*] B.A. 1985, J.D. 1988, University of Mississippi; LL.M. 1993, Columbia University; Ph.D. candidate (ABD), Vanderbilt University. The author will be a Visiting Professor of Law at the University of Memphis, Cecil C. Humphreys School of Law, during the 2001-02 academic year. The contributions to this piece of Professor Guff Abbott, Catherine Case, Mark Chinn, Nate Kellum, Sam Kelly, Governor Ronnie Musgrove, Professor Bob Weems and Judge William Willard are gratefully acknowledged.

appropriateness, despite conflicting reports from these same students regarding Featherstone's well-honed sense of humor in the classroom.

Professor Guff Abbott, Featherstone's good friend and long-time colleague (also retiring from the law school this year after a distinguished three-decade career), credits Chancery Court Judge William Willard ('75) of Clarksdale, Mississippi as an original creator of the "Iron Mike" nickname while a student. Having served in the United States Marine Corps, including a tour of duty in Vietnam just prior to starting law school, Judge Willard recalls that initial classes with Professor Featherstone—who also served in the military (United States Army) prior to his legal career—brought back memories of Paris Island boot camp. Judge Willard notes, however, that Professor Featherstone's gruff in-class exterior was belied by an obvious interest in and sincere concern for his students both inside and outside the classroom. Today, Judge Willard fondly remembers Professor Featherstone as "one of the many excellent professors I had at Ole Miss."

Former student Mark Chinn ('78), today a noted family law attorney in Jackson, Mississippi also recalls the contrast between Professor Featherstone's "Marine-like" classroom approach and his ubiquitous personal interaction with students outside the classroom, particularly at student parties. Chinn credits the fact that Featherstone "treated me like a person" both in and out of class as solidifying a strong connection to his alma mater that continues today. Another former student, current Mississippi Governor Ronnie Musgrove ('81), similarly recalls how his law student experience was enhanced by Professor Featherstone's practice of "treating us like adults" both inside and outside the classroom, including by actively "participating in our real lives" through such outlets as parties and intramural sports.

Indeed, as I personally observed during my own law student career at Ole Miss, "Iron Mike" engendered substantial affection in my fellow students—even those who survived his notoriously difficult Property courses—for his numerous interactions with them outside the classroom. My classmates often spoke enthusiastically of Professor

Featherstone's attendance at student-initiated parties, student gatherings he often hosted at his own home and his frequent participation in student tennis tournaments and other intramural activities. My wife's descriptions of growing up as a law professor's daughter include numerous stories of law school parties hosted at her house, or how her father often made a place at the family Thanksgiving or Christmas table for a law student unable to get home to family or friends for holidays.

Importantly, however, Professor Featherstone's greatest impact on his former students comes from inside, rather than outside, the classroom. Many successful former students credit Professor Featherstone's pragmatic approach to classroom teaching as having had a lasting influence on their professional careers. For example, Judge Willard aptly describes Professor Featherstone as a "very practical, very pragmatic" teacher whose primary goal was to help students become better practitioners. As an attorney and a judge, Willard acknowledges that he often reflects back on practical lessons learned in Featherstone's classroom in his day-to-day legal career. Governor Musgrove similarly expresses appreciation for Professor Featherstone's classroom emphasis on helping students mold the theoretical side of the law to the practical side, observing that the longer he is out of law school the more helpful he finds this analytical approach. The above testaments, although few in number for the sake of brevity, are nonetheless representative of Professor Featherstone's considerable influence on the lives and careers of numerous Ole Miss law school graduates.

Of all his former students save my wife, however, I have been the closest witness to Mike's greatest impact of all—his and his wonderful wife Sally's raising of four remarkable children to adulthood. Each of those children—Catherine, Janie, and the twins, Mike and Sam—inherited their father's huge heart and boundless love of family. This love of family is being passed down to his grandchildren—six at last count—to whom he is lovingly and affectionately known, not as "Iron Mike," but as "Pop." To them, "Pop" is not the stern and daunting presence of a law

professor, but a beloved teller of stories, a caretaker of birds, squirrels and flowers, a painter, a builder of birdhouses and other carpentry masterpieces and a baker of scratch biscuits extraordinaire (if permitted, my oldest son R.J. would eat nothing else). As affectionate a nickname as "Iron Mike" has become for generations of his former students, I think it entirely appropriate that in retirement it is the nickname bestowed by his grandchildren that will signify Professor Featherstone's most enduring legacy.

ABOUT MIKE FEATHERSTONE

Tom R. Mason[*]

It is fitting that the board and staff of the Mississippi Law Journal dedicate this issue to Professor David Michael "Mike" Featherstone. It is published as he begins his retirement from the faculty of this law school.

Mike joined this faculty almost thirty years ago after preparation which led him to this career-long association with this school. He did his undergraduate work at Davidson College then spent two years in the army as a lieutenant, much of that on the front of the cold war, the border between Germany and East Germany. He returned from that experience to work as a professional real estate appraiser for two years and then to law school at the University of South Carolina, followed by a masters in law at the University of Georgia. Following a year of teaching law at Mercer he joined this faculty in 1971 and has enjoyed the respect and affection of his students and his colleagues since then.

A part of the respect he has earned from those who know him stems from his exemplary performance in his roles of husband and father. His family, consisting of his wife, Sally, two daughters, Janie and Cathy, and twin sons, Mike and Sam, has been the bedrock of his life. His commitment to them has provided an inspiration and example to masses of students who have enjoyed the hospitality of his home at scores of parties, meetings and even classes, as well as to the faculty and staff of this school who have also been welcomed to his home. He has, in hosting those gatherings, demonstrated the openness and warmth which this school seeks as its reputation.

Mike's background developed in him a character of discipline, directness and a commitment to the highest of

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[*] Professor, University of Mississippi School of Law.

standards. He applied those traits in his teaching and his many close relationships with students. Early in his teaching career a group of his students, who appreciated his toughness, directness and good humor, dubbed him "Iron Mike" and presented him a drill instructor's campaign hat as their token of respect and affection for him. Since then that hat has been the centerpiece of his office, of which he is most proud. It symbolizes the many close and warm relationships he has enjoyed with his students and their appreciation of his unique personal qualities.

In recent years Mike has taught Property, and courses in Youth Court, Family Law and Eminent Domain. He has written books and articles in those fields and often lectured to lawyers and judges. He is widely known for his expertise in those areas and frequently consulted by lawyers trying to solve difficult problems. He has contributed greatly to the scholarship and the practice of the law in his fields of interest.

For almost twenty years he has served on the faculty of the National Judicial College, teaching Juvenile Law and Family Law. By this long term of service he has spread the name and proven the quality of this law school to judges from all parts of the country, doing as much as any other person to earn respect for and enhance the national reputation of this school.

On a personal note I recall that Mike was one of the first people I met when I came to interview for the faculty and, as was typical of them, he and Sally welcomed my wife and me into their home and shared their observations and judgments about this career and this institution. That influenced me to join him on this faculty. He has been a good and warm friend and colleague and I, with all the students, faculty and staff of this school, will miss having him here regularly. He will be around though, trying to figure out what to do in his retirement until Sally figures that out for him. We look forward to watching him enjoy the rest he has so well earned and for which we wish him the best of times.

A FAREWELL TO "IRON MIKE"

W. Steve Bozeman[*]

There were approximately 275 of us in the class that came together at the Ole Miss Law School in August of 1974, and like all law school classes, we came from varied backgrounds—some were former teachers, some were right out of undergraduate school and some were former military—we were all apprehensive about what lay ahead of us. We were told to "Look at the person to your right and the person to your left—two of you won't be here when this class prepares to graduate." Divided into three sections, the class of 1977 began its journey.

Dick Scruggs and I took every class and every section together—commissioned in the Navy together five years earlier, we were each glad to see a familiar face and we formed a study group that, on occasion, still exists today. We were in Mike Featherstone's Real Property class and the law that was communicated that first day—Iron Mike's law—still stands out in my memory: "Don't bring food or drinks into my classroom; don't be late—if the door is closed when you get here, do not open it; when I say 'listen,' I expect pens to be put down—do not take notes when I tell you to listen to me; if I say to write something down and commit it to memory, do it. You are all smart enough to finish this law school or you would not be here today. Those of you who finish, will finish because you had the courage to do the work. This is the *Law* you are studying, not English or history or political science—people don't 'practice' history—people 'practice' *Law*. Becoming a lawyer is a process, not an event—you come in here as 'guppies,' and if you are disciplined and work hard, you'll leave as 'frogs' and you won't have noticed when it happened. If you are not disciplined and don't work hard, you

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[*] J.D., *magna cum laude*, 1977.

won't make it here. If you earn an 'A' in this class, you'll get it; if you earn an 'F', you'll get it. I will not curve my grades." That was the Iron Mike that some never liked.

While some got thrown out of class for bringing in food or drink—"This is no picnic!"—and some got excoriated for opening the door and interrupting his lectures, there was another Iron Mike that I came to love and respect. The Iron Mike that kept advertised office hours so he could be found throughout the semester if a student had done the work and still had a question; the Iron Mike who never talked about his beloved Sally or his children in class, but who could be seen spending time with her and the little twin boys around town; the Iron Mike who showed up at Leslie's Pharmacy on Saturday mornings when the coffee and the lies flowed together on the square; the Iron Mike who spent time away from family and promised to meet with students and tutor them at night as finals approached for as long as any showed up and had done the work; the Iron Mike that taught us how to learn and that "having the courage" to do it was the essential ingredient to the practice of law.

As the final exam approached, we planned the surprise well—I bought the "Smokey the Bear" hat at Neilson's; Dick Scruggs got the red-checkered picnic tablecloth; Charlie Nelson had the gold name plate engraved and we gift-wrapped "Iron Mike's" drill instructor hat and placed it up front so he'd see it as he passed out the final exams. Years later, after we were "frogs," Scruggs and I told him we gave him the hat—he confided that he suspected us all along. I wonder if he suspected how much he really touched the lives of so many of us, and how much he motivated us, and how much we would miss him when he retired. I hope so. Godspeed "Iron Mike." Thanks.

CAUGHT IN THE CROSSFIRE: EMPLOYERS' LIABILITY FOR WORKPLACE VIOLENCE

Amy D. Whitten

Deanne M. Mosley[*]

I. INTRODUCTION

Contemporary headlines scream of shootings in schools and workplaces. Work mirrors life, and life in general is becoming more pressure-filled. As the economic engine has heated up during the 1990s, stories of workplace tragedy have become far too common.[1] *When surveyed about workplace violence, most employers say "It won't happen here . . . . Surely it can't be as bad as the media tries to make us believe . . . . We would know if we had a problem."*

The employers' statements above represent the fiction about workplace violence. The facts follow.

• About twenty workers in the United States are murdered each week, and about one million are assaulted every year. Factors that place workers at risk for violence in the workplace include: (1) interacting with the public, (2) exchanging money, (3) delivering services or goods, (4) working late at night or during early morning hours, (5) working alone, (6)

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[1] Fighting Back Against Workplace Violence, 11 No. 9 VA. EMPLOYMENT L. LETTER 1 (1999).

guarding property or valuables, and (7) dealing with violent people or potentially volatile situations.[2]

• As of 1998, one out of every six violent crimes occurred in the workplace, and homicide was the second leading cause of workplace death in the United States.[3]

• In 1996, the Society for Human Resources Management (SHRM) reported that nearly half of the 1016 human resource professionals polled were aware of at least one violent incident or threatened violent incident that occurred in their organizations between 1994 and 1996.[4]

• With respect to women, workplace violence is the number one cause of workplace death in the United States.[5]

• These numbers multiply in the public sector. Occupational Safety and Health Administration reports that the annual rate of nonfatal assaults against women working in state government is 8.6 times higher than against women working in the private sector. Women working in local government are 5.5 times more likely to be assaulted than those working in the private sector.[6]

• With respect to women in the workplace, around four million women were assaulted by husbands or boyfriends in 1994 alone. Many of these assaults are calculated toward the workplace since abusive partners often know the workplace is the place they are likely to find their partners.[7]

• According to a 1996 SHRM survey, the top three causes of violence in the workplace are personality conflicts, family or marital problems, and work-related stress.[8]

• Experts predict that in 99.9 percent of workplace violence cases, definite warning signs existed but were ignored.[9]

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[2] National Institute for Occupational Safety and Health Survey, 1997.

[3] United States Department of Justice Survey, 1999.

[4] Society for Human Resource Management, Survey on Workplace Violence, 1997.

[5] *Id.*

[6] Occupational Safety and Health Administration, 1997 Survey.

[7] Family Violence Prevention Fund Report, 1997.

[8] Society for Human Resource Management, Survey on Workplace Violence, 1997.

[9] MARIANNE MINOR, PREVENTING WORKPLACE VIOLENCE: POSITIVE MANAGEMENT STRATEGIES (1995).

• Of those persons who commit workplace murder, forty percent then commit suicide.[10]

The causes of workplace violence are as varied as are the persons driven to commit it. The leading cause of violence at work is crime, and the substantial number of intentional injuries in the workplace occur during the commission of a crime, most commonly robbery.[11] Less than ten percent of the remaining crimes are committed by current or former employees with an even lower percentage committed by relatives or other persons close to employees.[12] This latter category includes domestic violence that spills over into the workplace.

The costs associated with workplace violence have been estimated to be as high as $35 billion per year, a calculation which includes lost workdays, litigation costs, recovery costs and other expenditures.[13] The address of this potentially life and organization changing issue, one that occurred in Mississippi twenty-three times in 1997 and left twenty-two workers dead, is quite simply then, one of life and death. For employers, there are considerable legal effects as well, bringing in issues of prevention, response and potential liability. Beginning with an employer's "general duty" obligation to provide a safe and healthful workplace,[14] administered by the Occupational Safety and Health Act of 1970 (OSHA), and proceeding through bases of potential liability in tort, the employer owes a duty to its employees. Tort law also dictates risk for liability to customers and other third parties who enter the workplace. Employers trying to discharge these responsibilities must balance against the rights of employees under the Americans with Disabilities Act and other federal and state laws which relate to privacy. In sum, balancing the threat of violence from employees, customers and third parties against the threat of resulting litigation from those same groups is a delicate, but critically important, dance for employers.

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[10] *Id.*

[11] Bureau of Labor Statistics, U.S. Department of Labor, 1998.

[12] Human Resource Spotlight, Fall 2000.

[13] Workplace Violence Research Institute, 1999 Survey.

[14] 29 U.S.C. § 654(a) (1994).

The purpose of this article is to provide an integrated overview of many of the myriad legal issues which attend the issue of workplace violence as it confronts employers. Emphasis will be placed on both legal liability concerns as well as practical tools by which employers can prevent workplace violence or, where it occurs, act swiftly to redress it.

II. Liability of an Employer to Third Parties

Traditionally, an employer has faced an extensive circle of liability. The Restatement (Second) of Agency § 213 provides that "[o]ne who engages in an enterprise must take care to see that all instrumentalities, human or mechanical, which he uses are such as are not likely to cause harm to third parties."[15] Liability of employers for workplace violence is rapidly evolving as workplace violence incidents increase in both magnitude and volume. More times than not, the employer, as opposed to the perpetrator, is the one that many attempt to hold civilly responsible. In the context of workplace violence, employers potentially may be liable to employees and third-parties, as well as the perpetrator.[16] Liability may be direct or vicarious, and the price of liability can run high, since punitive damages may be allowable for the "willful, wanton, or reckless disregard for the safety of others."[17]

In certain situations, employers may find some relief. Employers may find some protection for accidents arising out of and in the course of employment based upon the exclusivity provision of workers' compensation laws.[18] As remedial social

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[15] Restatement (Second) of Agency § 213 (1957).

[16] The discussion which follows of various causes of action for workplace violence is by no means exhaustive. While an effort is made to explore the more significant instances by which an employer is exposed to liability, other claims may be raised depending upon the particular circumstances.

[17] Miss. Code Ann. § 11-1-65(1)(a) (Supp. 2000).

[18] *See, e.g.,* Griffin v. Futorian Corp., 533 So. 2d 461, 463-64 (Miss. 1988) (granting summary judgment to employer since exclusivity provision barred action). The Mississippi Act is applicable to all employers with five or more employees. Miss. Code Ann. § 71-3-5 (2000). For analysis of the development of the Mississippi Workers' Compensation Act, see Clark Monroe, Comment, *Accidental Injury Under the Mississippi Workers' Compensation Act: Fewer Compensable Claims and a Pandora's Box of Tort Liability*, 62 Miss. L.J. 689 (1993).

legislation, workers' compensation statutes generally provide employee benefits regardless of fault; however, such statutes typically preclude the employee from pursuing a negligence action.[19] Negligence actions in the employer-employee setting have been barred by the exclusivity provision in the Mississippi Workers' Compensation Law.[20] For example, in *Campbell v. Jackson Business Forms Co.*,[21] a plaintiff's claim for negligent supervision was barred by section 71-3-9 of the Mississippi Code, which provides that an employer's liability to pay workers' compensation is exclusive and "in place of all other liability" to the employee or his representatives.[22]

This umbrella of immunity applies to injuries which arise "out of and in the course of employment, without regard to fault" as to the cause of the injury or occupational disease.[23] It also includes injuries "caused by the willful act of a third person[24] directed against an employee because of his employment while so employed or working on the job."[25] However, even this immunity can be lost for intentional torts result-

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[19] Loretta F. Samenga, *Workers' Compensation-The Exclusivity Doctrine*, LAB. L.J. 13, 14-15 (Jan. 1990).

[20] Disney v. Horton, No. CIV.A.2:99-CV-0138, 2000 WL 490848, at *8 (N.D. Miss. April 14, 2000).

[21] 841 F. Supp. 772, 774-75 (S.D. Miss. 1994).

[22] MISS. CODE ANN. § 71-3-9 (2000). The Act provides that an employer can lose its immunity if it

> fails to secure payment of compensation as required . . . , an injured employee, or his legal representative in case death results from the injury, may elect to claim compensation under this chapter, or to maintain an action at law for damages on account of such injury or death. In such action the defendant may not plead as a defense that the injury was caused by the negligence of a fellow servant, nor that the employee assumed the risk of his employment, nor that the injury was due to the contributory negligence of the employee.

Id.

[23] MISS. CODE ANN. § 71-3-3 (2000).

[24] A "third person" has been interpreted as "a stranger to the employer-employee relationship or fellow employees acting outside the scope and course of his employment." Miller v. McRae's, Inc., 444 So. 2d 368, 371 (Miss. 1984).

[25] MISS. CODE ANN. § 71-3-3(b) (2000); *see* Green v. Glen Oaks Nursing Ctr., 722 So. 2d 147, 150 (Miss. Ct. App. 1998) (holding that employee who was assaulted and robbed on employer's premises by third party had compensable workers' compensation claim which was based upon risk created by her employment).

ing in damages that are not compensable under the Act.[26] Also, the employer's immunity does not extend to independent contractors who are not considered "employees" as defined by the Act.[27]

Another protection afforded to some employers is sovereign immunity, which may bar or otherwise limit some actions against public officials or the government.[28] The Mississippi Tort Claims Act provides the exclusive civil remedy for claims against the state and its political subdivisions in a tort action.[29] It is the intent of the Mississippi Legislature that the state and its political subdivisions are immune from suits in law and in equity,[30] and section 11-46-9 of the Mississippi Code maintains immunity for governmental entities and their employees acting within the course and scope of their employment or duties for items specifically enumerated.[31]

A. Respondeat Superior

The common law doctrine of respondeat superior is premised upon the employer's right to control work and the employer's responsibility to prevent tortious acts by employees

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[26] Stevens v. FMC Corp., 515 So. 2d 928 (Miss. 1987) (citing *Miller*, 444 So. 2d at 371).

[27] MISS. CODE ANN. § 71-3-3(d) (2000).

[28] The rationale behind sovereign immunity is that common law hoped to "protect the discretion of public officials so that those officials would not be deterred by the threat of suit from making decisions and formulating policies that are in the public good." T.M. v. Noblitt, 650 So. 2d 1340, 1343 (Miss. 1995) (citations omitted). Since the public decision-maker must consider public policy and not only established, reasonable standards, the reasonable person standard applied in tort law is often an inappropriate measure for the public sector. *Noblitt*, 650 So. 2d at 1343-44; *see, e.g.*, Phillips v. Thomas, 555 So. 2d 81, 85-86 (Ala. 1989) (discussing applicability of sovereign immunity to claims of negligent training, supervision, and licensing).

[29] MISS. CODE ANN. § 11-46-7(1) (Supp. 2000). For example, public school officials are immune from liability in an action alleging negligent supervision of students if the officials exercised ordinary care in the control and discipline of students pursuant to the Mississippi Tort Claims Act. L.W. v. McComb Separate Mun. Sch. Dist., 754 So. 2d 1136, 1141-42 (Miss. 1999).

[30] MISS. CODE ANN. § 11-46-3 (Supp. 2000). However, section 11-46-5 provides a limited waiver of such immunity. MISS. CODE ANN. § 11-46-5 (Supp. 2000).

[31] MISS. CODE ANN. § 11-46-9 (Supp. 2000).

in performance of said work.[32] The Mississippi Supreme Court has explained the doctrine as one who acts through another is himself the actor.[33] Respondeat superior allows the imposition of liability upon an employer without regard to the employer's fault for an employee's tortious acts performed in the course and scope of employment.[34] Often viewed as a way to obtain a "deep-pocket" defendant, courts have frequently found that an employer should bear the loss for his employees' torts and that such potential liability should serve as a motivating factor for employers.[35] The doctrine has been fully embraced by the Mississippi Supreme Court, which has found that the employer is the party in the best position to prevent or cure a dangerous condition and that it, in fact, has the burden to do so.[36]

Such liability is not absolute, and the employer is not liable for acts of an employee which are outside the scope of employment.[37] However, an employer may even be held liable for the intentional acts of its employees if the act is committed within the scope of employment or if the act was authorized or ratified by the employer.[38] Again, such liability is based on

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[32] White's Lumber & Supply Co. v. Collins, 191 So. 105, 106 (Miss. 1939).

[33] Slaughter v. Holsomback, 147 So. 318, 322 (Miss. 1933).

[34] McKee v. Brimmer, 39 F.3d 94, 96 (5th Cir. 1994); *see* Corley v. Burger King Corp., 56 F.3d 709, 710 (5th Cir. 1995) (finding employee must be acting within scope of employment to impute liability to employer); FSC Securities Corp. v. McCormack, 630 So. 2d 979, 986 (Miss. 1994) (holding securities broker-dealer not liable for acts of registered representative who acted outside scope of his representative status with FSC).

[35] *See generally* Harold J. Laski, *The Basis of Vicarious Liability*, 26 YALE L.J. 105 (1916).

[36] Tharp v. Bunge Corp., 641 So. 2d 20, 25 (Miss. 1994).

[37] Barmore v. Vicksburg, Shreveport & Pac. Ry. Co., 85 Miss. 426, 441 (1905). Specifically, liability does not exist where the employer can prove that the employee had abandoned his employment and was pursuing a purpose of his own which was not incident to the employment. *Id.*; *see also* Prairie Livestock Co., Inc. v. Chandler, 325 So. 2d 908, 910-11 (Miss. 1976) (holding if act committed by employee is done for employee's personal purpose and not in furtherance of interests of employer, act is not within scope of employment and employer is not liable).

[38] Horton v. Jones, 44 So. 2d 397, 400 (Miss. 1950). *But see* Patton v. S. States Transp., Inc., 932 F. Supp. 795, 801 (S.D. Miss. 1996) (citations omitted) (finding failure to discipline employee for assault does not constitute ratification). An intentional tort or criminal act may be within the scope of employment if the

the employer's right to control his employee.[39] As early as 1933, the Mississippi Supreme Court acknowledged that the "scope of employment" could be determined by the application of a myriad of enumerated tests.[40] In one such test, the deciding factor is whether the employee was acting to further the employer's business[41] or, more specifically, was the employee "engaged in affairs of his own or in pursuing some purpose unrelated to his master's business, acting as much outside the scope of his employment as he would be were his working day ended, or his task complete . . . ."[42] If the employee has aban-

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acts are "so closely connected with what the servant is employed to do, and so fairly and reasonably incidental to it, that they may be regarded as methods, even though quite improper ones, of carrying out the objectives of the employment." Domar Ocean Transp., Ltd. v. Indep. Ref. Co., 783 F.2d 1185, 1190 (5th Cir. 1986). To further complicate matters for employers, claims for insurance coverage of employee's intentional acts are generally excluded under a "deliberate acts" or "intentional acts" exclusion. Am. Guar. & Liab. Ins. Co. v. 1906 Co., 129 F.3d 802, 809-11 (5th Cir. 1997) (addressing insurance coverage where employee surreptitiously videotaped models in photography studio's dressing room). Also, when the employee's intentional act is the basis for claims of negligent hiring, negligent training or negligent entrustment, the Fifth Circuit anticipates that Mississippi courts will exclude insurance coverage. *Am. Guar. & Liab. Ins. Co.*, 129 F.3d at 810; *cf.* Reliance Nat'l Ins. Co. v. Estate of Tomlinson, 171 F.3d 1033, 1037-38 (5th Cir. 1999) (holding exclusion for injury arising out of negligent use of aircraft also excludes coverage for negligent entrustment and negligent supervision of aircraft); Bankers Multiple Line Ins. Co., Inc. v. Pierce, 20 F. Supp. 2d 1004, 1008 (S.D. Miss. 1998) (denying insurance coverage of negligent supervision claim where employee engaged in excluded conduct).

[39] Fruchter v. Lynch Oil Co., 522 So. 2d 195, 199 (Miss. 1988). In addition, an employer may be liable for an individual who is not his employee but over whom he has apparent control. Elder v. Sears, Roebuck & Co., 516 So. 2d 231, 235 (Miss. 1987) (allowing liability due to control exercised even though defendant argued actor was independent contractor and not its agent or employee).

[40] Loper v. Yazoo & Miss. Valley R.R. Co., 145 So. 743, 745 (Miss. 1933).

[41] *See, e.g.*, Odier v. Sumrall, 353 So. 2d 1370, 1372 (Miss. 1978) (enumerating test of whether act was means of accomplishing employment purposes and furthering business); Breland & Whitten v. Breland, 139 So. 2d 365, 367 (Miss. 1962) (holding if activity of employee is "purely personal and is disconnected from employment" the employer-employee relationship is suspended); Stovall v. Jepsen, 13 So. 2d 229, 230 (Miss. 1943) (enumerating test as whether "servant steps aside from the master's business for some purpose of his own disconnected from his employment . . . ."); *see also* Hahn v. Owens, 168 So. 622, 624 (Miss. 1936) (stating factor to be determined is if employee's conduct is "so unlike that authorized that it is substantially different").

[42] Seedkem S., Inc. v. Lee, 391 So. 2d 990, 995 (Miss. 1980). The *Seedkem* court followed the general rule that if an employee "deviates or departs from his

doned employment and is pursuing a personal purpose, the employer will not be liable under the doctrine of respondeat superior.[43] To be relieved from such liability, the burden is upon the employer to show that the employee "engaged in some purpose of his own in which the employer has no interest . . . ."[44]

For example, in the case of *Smith v. Gardner*,[45] the plaintiff brought suit against the employee and his employer based upon an automobile accident which occurred while the employee, an assistant college baseball coach from Texas, was in Meridian, Mississippi, for his team's baseball games.[46] After the team's curfew, the employee left the team at the hotel to purchase alcohol which he consumed upon his return to the hotel.[47] A few hours later, he then decided to again leave the hotel to purchase some tobacco and sightsee in downtown Meridian during which time the accident occurred.[48] The court determined that at the time of the accident the employee was a "frolicking employee" and conducting a personal errand which deviated from the scope of his employment.[49]

A unique situation is created where the employee attacks the plaintiff in an altercation that arises out of employment

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work to accomplish some purpose of his own not connected with his employment" the employer-employee relationship is temporarily suspended, during which time the employer is not liable for the tortious conduct of the employee. *Seedkem,* 391 So. 2d at 995 (quoting Int'l Shoe Co. v. Harrison, 63 So. 2d 837 (1953)).

[43] *Odier*, 353 So. 2d at 1372.

[44] Broadway v. Kelley Bros. Contractors, Inc., No. 1998-CT-01195-SCT, 2000 WL 730812, at *2 (Miss. June 8, 2000).

[45] 998 F. Supp. 708 (S.D. Miss. 1998).

[46] *Smith*, 998 F. Supp. at 709. The suit against the employer was based upon vicarious liability. *Id.* The employer filed a motion for summary judgment alleging that at the time of the accident, the employee was not acting within the course and scope of his employment. *Id.*

[47] *Id.* at 710.

[48] *Id.*

[49] *Id.* at 711. The court rejected the plaintiff's argument that the entire trip was part of the employee's employment since he was required to be away from home for an extended period of time. *Id.* Specifically, the court stated that the employee "was not in any sense about any conceivable business of the College; he was doing nothing toward the accomplishment of any purpose of his employment nor was he performing any act which might reasonably be considered incidental to his employment." *Id.*

but is not in furtherance of the employer's business.[50] According to Prosser and Keeton, where an employee-driver and plaintiff have an automobile accident and an altercation ensues, the majority of decisions would prevent liability from being imposed upon the employer absent a non-delegable duty.[51] However, more recent cases have exposed the employer to liability on the premise that the employment provides the opportunity for such situations to occur.[52] In *Stansell v. Safeway Stores, Inc.*,[53] a grocery store manager was determined to be within the scope of employment after arguing with a customer over an order and then striking the customer.[54] In expanding liability to the employer, factors to be considered are the time, place, and purpose of the act; the similarity of the act to acts the employee is authorized to conduct; the frequency of the act; the extent of departure from typical methods; any previous contact between the parties; and the employer's expectations as to if such an act would occur.[55]

It is often challenging to determine whether an action falls within the scope of employment in situations that allow the employees an opportunity to use their employment position to develop special relationships, such as law enforcement, health care workers, ministers and teachers. Often, this situation will occur when an act of sexual misconduct has been alleged. Generally, an employer cannot be liable via respondeat superior for an employee's sexual misconduct to a third party since such misconduct is "undertaken for personal gratification and not a purpose connected to employment."[56] However, sexual misconduct by law enforcement officers is an exception to the general rule.[57] This exception is based upon

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[50] Thatcher v. Brennan, 657 F. Supp. 6, 9 (S.D. Miss. 1986) (quoting W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 465-66 (5th ed. 1984)).

[51] *Id.*

[52] *Id.*

[53] 113 P.2d 264 (Cal. Dist. Ct. App. 1941).

[54] *Stansell*, 113 P.2d at 266.

[55] W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 502 (5th ed. 1984).

[56] State Farm Fire & Cas. Co. v. Century Indem. Co., 69 Cal. Rpt. 2d 403, 409 (Cal. Ct. App. 1997).

[57] *State Farm Fire & Cas. Co.*, 69 Cal. Rpt. 2d at 409 (citing Mary M. v. City

an officer being given "considerable public trust and authority."[58]

In allowing employers of law enforcement officers to face liability, courts also consider whether the alleged acts may have been done in furtherance of the officer's law enforcement duties. In *Hennagan v. Department of Highway Safety & Motor Vehicles*,[59] a Florida highway patrol officer allegedly detained a minor for suspicion of theft.[60] The officer took the minor into custody and drove her to an obscure location where he sexually molested her.[61] In denying the employer's motion to dismiss, the Florida court stated that it could not be said as a matter of law that the alleged acts of the officer were not done in furtherance of his duty to apprehend a shoplifting suspect.[62] Also, the court noted that it is the "purpose of the employee's acts rather than the method of performance thereof" which is the determinative factor.[63]

In similar situations, mental health workers and health care workers are often found to be acting within the scope of their employment. In *Simmons v. United States*,[64] a mental health counselor was determined to be within the scope of employment in providing mental health counseling when engaging in sexual relations with a patient.[65] Similarly, a hospital aide was found to be within the scope of employment when he sexually assaulted a patient since such was related to the aide's authorized duty of bathing the patient.[66]

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of Los Angeles, 814 P.2d 1341 (Cal. 1991); White v. County of Orange, 166 Cal. App. 3d 566 (Cal. 1988)).

[58] Applewhite v. City of Baton Rouge, 380 So. 2d 119, 121 (La. Ct. App. 1979). The City of Baton Rouge was held liable for a police officer's sexual assault of a pedestrian that he took into custody for vagrancy. *Applewhite*, 380 So. 2d at 120-22. In rejecting the city's argument that the sexual assault was beyond the scope of employment, the Louisiana court noted that the officer was on duty, armed, in uniform and in a police vehicle. *Id.* at 121.

[59] 467 So. 2d 748 (Fla. 1985).

[60] *Hennagan*, 467 So. 2d at 749.

[61] *Id.*

[62] *Id.* at 751.

[63] *Id.*

[64] 805 F.2d 1363 (9th Cir. 1986).

[65] *Simmons*, 805 F.2d at 1368-71.

[66] Stropes v. Heritage House Children's Ctr. of Shelbyville, Inc., 547 N.E.2d

Consistent with the general rule, sexual misconduct by a minister has been determined not to be within the scope of employment.[67] Since the unauthorized acts of sexual molestation were not sufficiently associated with the minister's duties, an action premised upon respondeat superior could not be maintained.[68] When teachers have been accused of sexual misconduct with students, such misconduct is often found to be beyond the scope of employment. In *Landreneau v. Fruge*,[69] a physical education teacher was determined to be beyond the scope of her employment when she enticed a student into sexual activity.[70] As a result, respondeat superior could not be used to hold the principal and school board liable.[71] However, courts have noted that while employers of teachers may not be liable based upon the doctrine of respondeat superior, they may be liable for negligent hiring or negligent supervision based upon the negligence of the employer.[72]

B. Negligence

Due to the often inadequacy of respondeat superior in the context of workplace violence, other actions are emerging and being utilized to base liability upon the fault of the employer. Whereas respondeat superior focused upon the conduct of the employee, negligence actions, in contrast, revolve around the action or inaction of the employer. An employer can be held

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244, 249 (Ind. 1989).

[67] Konkle v. Henson, 672 N.E.2d 450, 457 (Ind. Ct. App. 1996).

[68] *Konkle*, 672 N.E.2d at 457.

[69] 676 So. 2d 701 (La. Ct. App. 1996).

[70] *Landreneau*, 676 So. 2d at 751.

[71] *Id.* The Louisiana court stated that

> [g]enerally speaking, an employee's conduct is within the course and scope of employment if the conduct is of the type that he is employed to perform, occurs substantially within the authorized limits of time and space, and is motivated at least in part by a purpose to serve the employer.

Id.

[72] *State Farm Fire & Cas. Co.*, 69 Cal. Rpt. 2d at 409 n.6. In *State Farm Fire & Casualty Co.*, the California court found that the allegations of the teacher sexually molesting students did not fall within the scope of the teacher's duties, and the school district could not be held liable based upon respondeat superior. *Id.* at 413.

liable if an employee's actions are outside of the scope of employment if the employer, itself, committed negligence. In a negligence action, plaintiffs typically argue that there is a causal link between the employer's negligence in employment and the subsequent violence. Significantly, if the employer has committed negligence, Mississippi courts view liability as the rule and immunity from liability as the exception.[73]

Historically, negligence[74] has served as a means of legal redress when other causes of action were not sufficient or available.[75] The rules of common law negligence apply in Mississippi in the absence of an applicable statute.[76] Whenever an action is taken, the law imposes a duty that such action be taken with reasonable care.[77]

As with all negligence actions, the conventional elements that a plaintiff must show, by a preponderance of the evidence,[78] are the existence of a duty to conform to a specific standard of conduct,[79] breach of said duty, breach of duty was

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[73] Glaskox v. Glaskox, 614 So. 2d 906, 911 (Miss. 1992).

[74] Negligence has been defined as "the failure of one owing a duty to another to do what a reasonable and prudent person would ordinarily have done under the circumstances." Cole v. Delchamps, Inc., 152 So. 2d 911, 913 (Miss. 1963) (citation omitted).

[75] Chadwick v. Bush, 163 So. 823, 824 (Miss. 1935). Prior to Mississippi enacting any statutes, it was

> the established law of the land . . . that an actionable wrong has been committed when a responsible person has neglected to use a reasonable degree of care and diligence for the protection of another person from such injury as under the existing circumstances should reasonably have been foreseen as a natural and proximate consequence of that negligence.

Chadwick, 163 So. at 824. In addition, negligence actions, such as negligent hiring, are more encompassing than respondeat superior.

[76] *Id.*

[77] Dr. Pepper Bottling Co. of Miss. v. Bruner, 148 So. 2d 199, 201 (Miss. 1962). The duty of care is qualified; it must be reasonable not absolute. Stelly v. Barlow Woods, Inc., 830 F. Supp. 936, 942 (S.D. Miss. 1993). However, the degree of care generally increases in proportion to the degree of danger. Shurley v. Hoskins, 271 So. 2d 439, 444 (Miss. 1973).

[78] K-Mart Corp. v. Hardy, 735 So. 2d 975, 981 (Miss. 1999) (stating negligence elements must be proven by preponderance of evidence).

[79] A "duty" is considered to be the basis of a negligence claim. Gulf, Mobile & N. R.R. Co. v. Sparkman, 177 So. 760, 762 (Miss. 1938). For the plaintiff to recover, it must be proven that there was "some obligation or duty toward the plaintiff which the defendant has left undischarged or unfulfilled." *Gulf, Mobile &*

the proximate cause of plaintiff's injury[80] and damages which resulted to plaintiff.[81] Correspondingly, the traditional defenses to negligence, such as an unforeseeable event[82] or superseding cause,[83] would also apply in a workplace violence case.

A defense of particular interest in workplace violence cases is whether a criminal act committed constitutes a superseding cause. In *Shelton v. Board of Regents*,[84] the employer successfully argued that the criminal acts of its employee acted as an efficient intervening cause which negated the claim that the employer's negligence was the proximate cause of the plaintiffs' damages.[85] The court found placing liability

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N. R.R. Co., 177 So. at 762. The applicable standard of care is measured by how a reasonable and prudent person would have acted under the same or similar circumstances. Donald v. Amoco Prod. Co., 735 So. 2d 161, 175 (Miss. 1999).

[80] In *Mississippi City Lines, Inc. v. Bullock*, 13 So. 2d 34, 36 (Miss. 1943), the Mississippi Supreme Court held that an "act which merely furnishes the condition or occasion upon which injuries are received, but which does not put in motion the agency by or through which injuries are inflicted" does not constitute proximate cause. *Bullock*, 13 So. 2d at 36. Proximate cause is the continual sequence of events, absent any efficient intervening cause, which produces an injury which would not have otherwise occurred. Grisham v. John Q. Long V.F.W. Post, No. 4057, Inc., 519 So. 2d 413, 417 (Miss. 1998).

[81] Palmer v. Biloxi Reg'l Med. Ctr., Inc., 564 So. 2d 1346, 1355 (Miss. 1990). It is significant to note that the duty owed to a plaintiff is determined by the relationship between the parties. Skelton v. Twin County Rural Elec. Ass'n, 611 So. 2d 931, 935 (Miss. 1992).

[82] Swan v. I.P., Inc., 613 So. 2d 846, 856 (Miss. 1993) (finding defendant is not liable for unforeseeable injuries).

[83] If an independent, intervening cause is the sole, proximate cause, then the first actor's negligence is irrelevant. Pargas of Taylorsville, Inc. v. Craft, 249 So. 2d 403, 408 (Miss. 1971). However, an actor's negligence is not insulated if the intervening cause was within the realm of reasonable foreseeability. McCorkle v. United Gas Pipe Line Co., 175 So. 2d 480, 489 (Miss. 1965).

[84] 320 N.W.2d 748 (Neb. 1982). Plaintiffs, the personal representatives of victims poisoned by Steven Roy Harper, brought suit against the employer for several claims, including negligent hiring based upon his criminal history. *Shelton*, 320 N.W.2d at 750-51. Prior to his employment with the subject employer, Harper attempted to kill Sandra Marchant and her husband following the termination of a relationship with Ms. Marchant. *Id.* at 751. Harper subsequently pled guilty to the crime of intent to kill, wound or maim. *Id.* While on parole, Harper was employed as a research technologist by the subject employer. *Id.*

[85] *Id.* at 752-54. *The Restatement (Second) of Torts* provides that a third person's act

> in committing an intentional tort or crime is a superseding cause of harm

upon an employer for an employee stealing a poisonous drug from the employer and breaking into the victims' home to mix the poison in lemonade and milk to be consumed by the victims required "too great a leap of faith."[86] To hold otherwise and not consider the criminal acts of the employee as superseding causes would impose upon the employer the duty of insuring the general public.[87]

The Fifth Circuit Court of Appeals, in applying Mississippi law in a premises liability case, held that an intentional criminal act of another party did not absolve the property owner of liability.[88] However, if the criminal act was not reasonably foreseeable, the criminal act could arguably constitute a superseding cause.[89] Furthermore, the Mississippi Supreme Court has recognized that "there is less reason to anticipate premeditated and malicious acts as opposed to acts which are merely negligent."[90] Citing Prosser, the court stated that one may assume that others will obey the criminal law absent any reason to suspect otherwise.[91]

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to another resulting therefrom, although the actor's negligent conduct created a situation which afforded an opportunity to the third person to commit such a tort or crime, unless the actor at the time of his negligent conduct realized or should have realized the likelihood that such a situation might be created, and that a third person might avail himself of the opportunity to commit such a tort or crime.

RESTATEMENT (SECOND) OF TORTS § 448 (1965); *cf.* Konkle v. Henson, 672 N.E.2d 450, 457 (Ind. Ct. App. 1996) (stating employer can be vicariously liable for employee's criminal act).

[86] *Shelton*, 320 N.W.2d at 753. The court noted that even if the employer had conducted a background investigation on the employee, it would not have reasonably known it should not hire the employee for his particular job, working with experimental rats. *Id.*

[87] *Id.* at 754.

[88] Whitehead v. Food Max of Miss., Inc., 163 F.3d 265, 271-72 (5th Cir. 1998).

[89] *Whitehead*, 163 F.3d at 271.

[90] Robinson v. Howard Bros. of Jackson, Inc., 372 So. 2d 1074, 1076 (Miss. 1979) (citing PROSSER, LAW OF TORTS 173-74 (4th ed. 1971)).

[91] *Robinson*, 372 So. 2d at 1076 (citing PROSSER, LAW OF TORTS (4th ed. at 173-74)).

1. Negligent Hiring

An employer in Mississippi is charged with the duty to exercise due care in hiring.[92] The common law fellow-servant rule imposing a duty upon employers to hire employees whose presence would not present a danger to fellow employees is the origin for the causes of action of negligent hiring and negligent retention.[93] In *Country Club v. Turner*,[94] the Mississippi Supreme Court stated that

> [c]ompliance with the duty to use reasonable care to maintain working conditions that are reasonably safe involves the duty to use such care in avoiding the employment or retention of a servant who is known to be dangerous or vicious where such propensities are calculated to expose co-employees to greater dangers than the work necessarily entails.[95]

Accordingly, an employer may be liable for the employee's negligence if the employer knew or should have known of the employee's incompetencies.[96]

Negligent hiring is distinguishable from the doctrine of respondeat superior as the former addresses the risk created by the employer in exposing the public to a violent employee while the latter is based upon the principle that an employer may be liable for the actions of its employees.[97] The specific elements which must be proven to show negligent hiring of an employee with a propensity for violence are as follows: (1) the employee in fact had a propensity for violence; (2) the employer knew[98] or should have known of the propensity for violence;[99] and (3)

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[92] *See generally* Jones v. Toy, 476 So. 2d 30 (Miss. 1985).

[93] William J. Woska, *Negligent Employment Practices*, LAB. L.J. 603, 603 (Sept. 1991).

[94] 4 So. 2d 718 (Miss. 1941).

[95] *Country Club*, 4 So. 2d at 719.

[96] *Jones*, 476 So. 2d at 31.

[97] Di Cosala v. Kay, 450 A.2d 508, 515 (N.J. 1982).

[98] At least one legal commentator has concluded that employers are ironically discouraged from conducting background investigations since actual knowledge may lead to liability. Dermot Sullivan, *Employee Violence, Negligent Hiring, and Criminal Records Checks: New York's Need to Reevaluate Its Priorities to Promote Public Safety*, 72 ST. JOHN'S L. REV. 581, 594 (1998).

[99] Stanley v. Brooks, 436 S.E.2d 272, 274 (N.C. Ct. App. 1993) (holding em-

the employer hired the employee negligently or with callous disregard for the rights of persons who would reasonably be expected to come into contact with the employee.[100]

While criminal charges such as possession of a dangerous weapon and drugs may indicate a propensity to engage in criminal behavior, such charges do not necessarily indicate a propensity to engage in violent activities.[101] Similarly, where a background investigation reveals that the applicant misrepresented information on the job application, it may reveal a propensity for lying but not a propensity for violence.[102] In order for liability to attach, there must be specific proof that the employee "was a person of known vicious character or one whom the employer should have known had a vicious character."[103] Accordingly, the employee's character is often put into issue at trial, and the jury, much to the dismay of employers, may learn of the employee's reputation, prior negligent or intentional acts and criminal history.[104]

Courts have found a breach of the employer's duty in situations where a reasonable background investigation would have revealed the violent propensities of the applicant.[105] Correspondingly, where the employer fails to conduct a background investigation but the investigation would not have resulted in

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ployer not liable for alleged sexual assault of plaintiff while test driving car since no evidence employer knew or should have known of employee's criminal history). Where the employer has constructive knowledge of the employee's violent propensities, a majority of jurisdictions will uphold liability. Mark Minuti, Note, *Employer Liability under the Doctrine of Negligent Hiring: Suggested Methods for Avoiding the Hiring of Dangerous Employees*, 13 DEL. J. CORP. L. 501, 515 (1988). The majority of jurisdictions also agree that "an employer who negligently either hires or retains in his employ an individual who is incompetent or unfit for the job, may be liable to a third party whose injury was proximately caused by the employer's negligence." *Di Cosala*, 450 A.2d at 514.

[100] Patton v. S. States Trans., Inc., 932 F. Supp. 795, 801 (S.D. Miss. 1996).

[101] *Patton*, 932 F. Supp. at 801. The court specifically noted that the possibility of engaging in violent activity while armed with a dangerous weapon was insufficient where there was no evidence of any violent activity. *Id.*

[102] Edwards v. Robinson-Humphrey Co., 298 S.E.2d 600, 603-04 (Ga. Ct. App. 1982).

[103] *Patton*, 932 F. Supp. at 801 (citations omitted).

[104] Minuti, *supra* note 99, at 507.

[105] *Id.* at 502.

any evidence that the employee had violent propensities, then the negligent hiring claim will not be successful.[106]

Unfortunately, there is no uniform rule to determine the sufficiency of an employer's investigation.[107] The Rhode Island Supreme Court has enumerated the employer's duty as the following:

> [Whether t]he sensitive nature of the employment, coupled with the opportunity and temptations incident to it, would lead to the conclusion that a prudent employer in these circumstances should rely on more than the absence of specific evidence or statements that a potential employee is dishonest or criminally inclined.[108]

The duty to conduct an investigation and the extent of said investigation often coincides with the employee's job responsibilities and the degree of contact with third parties.[109] If the employee will have minimum contact with others, the employer may be found to fulfill his duty simply by obtaining employment history and personal information during an interview.[110] Prospective employees with more significant contacts with third

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[106] *Id.* at 523; *see also* Williams v. Feather Sound, Inc., 386 So. 2d 1238, 1241 n.9 (Fla. Dist. Ct. App. 1980) (stating summary judgment for employer's failing to make background investigation would be appropriate if nothing suspect in employee's background would have been found).

[107] Minuti, *supra* note 99, at 515. Where employees deal with the public, courts have found that the employer does not have an absolute duty to conduct a criminal records background check. However, one wonders whether a jury will be as forgiving when it is presented with a laundry list of felony convictions of which the employer had no knowledge due to the failure to conduct a criminal records background check.

[108] Welsh Mfg. v. Pinkerton's, Inc., 474 A.2d 436, 441 (R.I. 1984). In *Garcia v. Duffy*, 492 So. 2d 435 (Fla. Dist. Ct. App. 1986), a Florida court enumerated the test as "whether the employer exercised the level of care which, under all the circumstances, the reasonably prudent man would exercise in choosing or retaining an employee for the particular duties to be performed." *Garcia*, 492 So. 2d at 440.

[109] One court summarily stated that "[t]he scope of the investigation is directly related to the severity of risk third parties are subjected to by an incompetent employee." Ponticas v. K.M.S. Investments, 331 N.W.2d 907, 913 (Minn. 1983); *see also Garcia*, 492 So. 2d at 441.

[110] *Garcia*, 492 So. 2d at 441. "Slight care" might be sufficient if the employee is a yardman or production line worker. Kendall v. Gore Properties, 236 F.2d 673, 678 (D.C. Cir. 1956).

parties may require that the employer conduct a background investigation, since it is by virtue of the employment that the employee and third party come into contact.[111] Also, when employees will be in a relationship with a particular indicia of trust, such as landlord[112] or common carrier,[113] the employer seems to have a heightened duty. However, even with the heightened duty, not all courts agree that there is an affirmative duty to examine criminal records as a part of the background investigation.[114] These courts stress that (1) liability should be predicated on the totality of the circumstances surrounding the allegedly negligent hiring rather than upon the absence of a criminal history investigation,[115] and (2) that ac-

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[111] A majority of courts impose upon employers a "duty to exercise reasonable care in view of all the circumstances in hiring individuals who, because of the employment, may pose a threat of injury to members of the public." *Ponticas*, 331 N.W.2d at 911.

[112] *Kendall*, 236 F.2d at 678 (stating "very different series of steps are justified if an employee is to be sent, after hours, to work for protracted periods in the apartment of a young woman tenant, living alone"); *Ponticas*, 331 N.W.2d at 912-13 (finding employer had heightened duty where resident manager of apartment complex with passkey to all units sexually assaulted tenant). A tenant had the right to expect that a landlord would not assign an unsupervised employee to work in her apartment if the landlord had not exercised any care to ascertain the employee's trustworthiness. *Kendall*, 236 F.2d at 678. Also, a tenant could reasonably expect that a landlord would not give passkeys to a stranger or allow a person "bent on mischief" to obtain passkeys. *Id.*

[113] *See, e.g.*, Salinas v. Fort Worth Cab & Baggage Co., 725 S.W.2d 701 (Tex. 1987) (awarding plaintiff $5,000,000 in damages where she was sexually assaulted by cab driver); Malorney v. B & L Motor Freight, Inc., 496 N.E.2d 1086 (Ill. App. Ct. 1986) (holding that where employee denied criminal record of sexual assaults, failure of his employer to investigate his criminal record was sufficient to create jury issue where employer allegedly raped hitchhiker).

[114] *Ponticas*, 331 N.W.2d at 913. Specifically, the *Ponticas* court found that "[i]f the employer has made adequate inquiry or otherwise has a reasonably sufficient basis to conclude the employee is reliable and fit for the job, no affirmative duty rests on him to investigate the possibility that the applicant has a criminal record." *Id.* The Maryland Court of Appeals agreed that ordinarily an employer does not have a duty to check criminal records. Evans v. Morsell, 395 A.2d 480, 484 (Md. Ct. App. 1978); *accord* C.C. v. Roadrunner Trucking, Inc., 823 F. Supp. 913, 924 (D. Utah 1993) (holding employer not required to conduct criminal background check, particularly in foreign countries, under Utah law); Williams v. Feather Sound, Inc., 386 So. 2d 1238, 1240 n.8 (Fla. Dist. Ct. App. 1980) (rejecting argument that employer had duty as matter of law to conduct criminal records investigation).

[115] *Ponticas*, 331 N.W.2d at 913. Furthermore, a public policy argument has

tual knowledge of a criminal record does not constitute negligent hiring as a matter of law.[116] Furthermore, it has been argued that an employer "to some extent is entitled to rely upon the determination of the government's criminal justice system that the individual is ready to again become an active member of society."[117]

Frequently the "heightened duty" will occur where, by virtue of employment, the employee gains access to the victim's residence. In *D.R.R. v. English Enterprises*,[118] the employer furnished a passkey to the employee to install cable, and the employee subsequently raped the apartment owner.[119] The court noted that the special duty may have been breached by the employer's failure to conduct a criminal records background check.[120] Companies with door-to-door salespersons also may be found to have a duty to conduct background investigations that include criminal records checks.[121] In *Scott Fetzer Co. v.*

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been presented that a mandatory criminal records check would be contrary to the efforts to rehabilitate those with prior criminal records in order that they can be assimilated into our communities and gainfully employed. *Cf. Williams*, 386 So. 2d at 1241.

[116] Garcia v. Duffy, 492 So. 2d 435, 441 (Fla. Dist. Ct. App. 1986); *Evans*, 395 A.2d at 484. The nature of the criminal record and the specific circumstances would have to be taken into account before a prima facie case of negligent hiring could be made. *Evans*, 395 A.2d at 484 n.4 (citations omitted); Gaines v. Monsanto Co., 655 S.W.2d 568, 571 n.2 (Mo. Ct. App. 1983).

[117] *Evans*, 395 A.2d at 484. The *Evans* court also pointed out that it would be a significant burden for employers to routinely conduct criminal background investigations. *Id.*

[118] 356 N.W.2d 580 (Iowa Ct. App. 1984).

[119] *D.R.R.*, 356 N.W.2d at 584.

[120] *Id.*

[121] Bennett v. T & F Distrib. Co., 285 A.2d 59, 61 (N.J. Super. App. Div. 1971). The employer must be cautious in his quest not to run afoul of other legal authority. In considering criminal records, the Eighth Circuit Court of Appeals stated

> [w]e cannot conceive of any business necessity that would automatically place every individual convicted of any offense, except a minor traffic offense, in the permanent ranks of the unemployed. This is particularly true for blacks who have suffered and still suffer from the burdens of discrimination in our society. To deny job opportunities to these individuals because of some conduct which may be remote in time or does not significantly bear upon the particular job requirements is an unnecessarily harsh and unjust burden.

Green v. Mo. Pac. R.R. Co., 523 F.2d 1290, 1298 (8th Cir. 1975). In *Green*, an ap-

Read,[122] the employer did not conduct a background investigation and did not attempt to verify any information on the application or the employee's references.[123] Subsequently, the employee sexually assaulted a customer while demonstrating a vacuum cleaner to her in her own home.[124] The court determined that the employer had a "duty to take reasonable precautions to prevent or deter its distributors from hiring persons with histories of crime, violence, or sexually deviant behavior" as door-to-door salespersons performing in-home demonstrations.[125]

In one of the few Mississippi cases to address workplace violence, the employer was absolved of liability.[126] In *Thatcher v. Brennan*, a medical sales specialist and his employer were sued by the plaintiff who was assaulted in an altercation following a traffic dispute with the employee.[127] The plaintiff's suit was based upon respondeat superior and negligent hiring.[128] Although the incident occurred while the employee was engaged in the employer's business,[129] the court found that

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plicant was denied employment based upon a policy of refusing employment to any person convicted of a crime other than a minor traffic offense. *Green*, 523 F.2d at 1292. The applicant had been convicted of refusing military induction. *Id.* The court found the rejection of his application to be a violation of Title VII. *Id.* at 1298-99.

[122] 945 S.W.2d 854 (Tex. Ct. App. 1997).

[123] *Scott Fetzer Co.*, 945 S.W.2d at 858. Had the employer conducted a background investigation he would have learned that the employee had been arrested and had deferred adjudication for exposing himself to children, that he had exposed himself to a co-employee, that his previous employers received complaints of inappropriate sexual conversations and obscene phone calls and that he had been evicted from an apartment due to sexually inappropriate conduct. *Id.* A past employer's records contained a copy of the employee's confession when he was arrested for exposure which stated in pertinent part "I have this thing in my mind that controls me at times. I can't help what I do . . . I know I need help. I want someone to help me. I need the help before the devil controls me." *Id.*

[124] *Id.* at 858. The jury awarded actual damages in the amount of $1,500,000.00. *Id.* at 858-59.

[125] *Id.* at 866.

[126] Thatcher v. Brennan, 657 F. Supp. 6 (S.D. Miss. 1986).

[127] *Thatcher*, 657 F. Supp. at 8. Brennan was an employee of Mead Johnson and sold pharmaceutical products. *Id.*

[128] *Id.* at 7.

[129] The fact that an incident occurs during the time and place of employment does not automatically indicate that such is within the scope of employment. Can-

the employee was not authorized to assault others nor was his conduct similar to acts the employee was authorized to perform.[130] The assault was not committed to further the interests of the employer, but was a personal objective of the employee.[131] Sensitive to the expansion of liability to employers,[132] the court noted that an "employer cannot be the insurer of safety of all persons with whom the employee comes in contact."[133]

With regard to the claim for negligent hiring, the court determined that the factors promulgated in *Jones v. Toy* should be applied to the negligent hiring of an employee with a propensity for violence.[134] Therefore, the plaintiff had to prove that the employee had a propensity for violence, that the employer knew or should have known of such propensity and the employer hired the employee negligently or with callous disregard for the rights of people with whom the employee could reasonably be expected to come into contact.[135] The plaintiff alleged that the employer was aware of the employee's propen-

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ton Cotton Warehouse Co. v. Pool, 28 So. 823, 824 (Miss. 1900).

[130] *Thatcher*, 657 F. Supp. at 9. Also, the court pointed out that there was no evidence indicating that the employer would condone such actions, and that the act was not a "normal" method of selling, nor was it commonly performed by other employees. *Id.*

[131] *Id.* The *Thatcher* court also distinguished the case sub judice from *Pritchard v. Gilbert*, 236 P.2d 412 (Cal. Dist. Ct. App. 1951), which allowed the employer to be exposed to liability even though an assault following a traffic dispute did not further the employer's interest. *Thatcher,* 657 F. Supp. at 9-10.

[132] The court noted that Minnesota previously followed the "motivation" test which focuses on whether an employee was motivated to further an employer's business in his actions. *Thatcher*, 657 F. Supp. at 10 n.2. In 1973, Minnesota abandoned the "motivation" test in favor of a rule which provides that the "employer is liable for an assault by his employee when the source of the attack is related to the duties of the employee and . . . occurs within the work related limits of time and place." *Id.* (quoting Lange v. Nat'l Biscuit Co., 211 N.W.2d 783, 786 (Minn. 1973)).

[133] *Thatcher*, 657 F. Supp. at 10.

[134] *Id.* at 10-11. A possibility of violence is not sufficient. *Id.* at 11 (citing Offshore Logistics, Inc. v. Astro-Marine, Inc., 482 F. Supp. 1119, 1121 (E.D. La. 1980)). There must be evidence that the employee "was a person of known vicious character or one whom the employer should have known had a vicious character." *Thatcher,* 657 F. Supp. at 11 (citing Schultz v. Evelyn Jewell, Inc., 476 F.2d 630, 631 (5th Cir. 1973)).

[135] *Thatcher*, 657 F. Supp. at 11.

sity for violence as a result of both a personality inventory and adaptability test administered to the employee prior to his hiring which indicated he was "a person of 'high aggression'" and "undergoing a great deal of emotional and personal stress and turmoil."[136] However, in granting the employer's motion for summary judgment, the court found that the test results were not sufficient to place the employer on notice of any violent tendencies of the employee.[137] The court further found that the lack of any violent behavior by the employee during the span of time between the administration of the tests and the altercation "belies any claim of negligent hiring under the circumstances of this case."[138]

2. Negligent Retention

Although similar to negligent hiring, negligent retention is primarily distinguishable based upon the employer's receipt of notice of the employee's unfitness.[139] While negligent hiring is based upon the employer receiving such notice prior to the employment, in an action for negligent retention the plaintiff posits the employer became aware or should have become aware of the employee's unfitness during the course of employment.[140] Although not in the context of workplace violence, the Mississippi Supreme Court has recognized negligent retention and stated as follows:

> The retention of an incompetent servant after the master has had reasonable notice, either direct or constructive, of such incompetence, constitutes negligence on the part of the master; the master is chargeable with knowledge of the incompetency of the servant if by the exercise of due care he could

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[136] *Id.* The tests were given to the employee prior to his hiring in February 1982. *Id.* A clinical psychologist testifying for the plaintiff stated that, based upon the results, the employee manifested evidence of "very serious emotional and personality instability." *Id.*

[137] *Id.* at 12. The court noted that the tests were administered in 1981 and that the altercation did not occur until May 1984, and there was no evidence of violence during this period. *Id.*

[138] *Id.*

[139] Garcia v. Duffy, 492 So. 2d 435, 438 (Fla. Dist. Ct. App. 1986).

[140] *Garcia*, 492 So. 2d at 438-39.

have ascertained such incompetence.[141]

The cause of action of negligent retention reinforces that an employer must take adequate action upon employee misconduct and must also stress to supervisors the need to alert management of inappropriate behavior. To maintain an action for negligent retention, the threshold may be met if the employer has notice of an employee's violent behavior.[142] Typically, the cause of action "occurs when, during the course of employment, the employer becomes aware or should have become aware of problems with an employee that indicate his unfitness, but the employer fails to take further action, such as investigation, discharge, or reassignment."[143] Notice may be sufficient where the employee's coworkers, who are also his friends, have knowledge of his violent behavior.[144] Even where no employees in a supervisory position have notice, the knowledge of the violent employee's coworker-friends may be imputed to the employer.[145]

In *Southern Bell Telephone & Telegraph Co. v. Sharara*,[146] a Georgia appellate court was faced with a type of case where it is often argued that the heightened duty should be applied.[147] The plaintiff brought suit against the telephone company and its repairman for a physical assault which occurred in the plaintiff's home after the repairman completed an installation.[148] In situations where the violence occurs during

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[141] Hamilton Bros. Co. v. Weeks, 124 So. 798, 800 (Miss. 1929).

[142] Pittard v. Four Seasons Motor Inn, Inc., 688 P.2d 333, 341 (N.M. Ct. App. 1984) (finding employer's notice of violent behavior sufficient to maintain negligent retention claim for sexual assault).

[143] Tallahassee Furniture Co., Inc. v. Harrison, 583 So. 2d 744, 753 (Fla. Dist. Ct. App. 1991) (citation omitted).

[144] Bryant v. Livigni, 619 N.E.2d 550, 555-56 (Ill. App. Ct. 1993).

[145] *Bryant*, 619 N.E.2d at 556. One justice on the *Bryant* court argued that the majority opinion's message to employers is that any employee involved in an altercation must be fired to avoid liability for negligent retention. *Id.* at 560 (Welch, J., concurring in part and dissenting in part).

[146] 307 S.E.2d 129 (Ga. Ct. App. 1983).

[147] *S. Bell Tel. & Tel. Co.*, 307 S.E.2d at 129.

[148] *Id.* at 130. The repairman, who had been employed with the employer for over eleven years, subsequently pled guilty to aggravated assault. *Id.* The plaintiff unsuccessfully argued that the employer should be liable because he knew or should have known that the employee was having marital difficulties. *Id.* at 130-

a period of ostensible employment in the victim's home, liability is not automatically imposed upon the employer.[149] However, it was suggested in a concurring opinion that employees who enter customers' homes should be "more closely checked, observed, screened and interviewed by employers as to any outward manifestation of dangerous propensities relating to aggression or violence."[150]

In *Tallahassee Furniture Co. v. Harrison*,[151] the plaintiff was violently attacked in her home by a deliveryman who had delivered furniture to her months earlier.[152] At trial, it was proven that the deliveryman used drugs and alcohol on the job, and the employer was aware of the employee's psychiatric hospitalization.[153] In an effort to avoid liability, the employer argued that the attack occurred during a non-employment entry into the plaintiff's residence.[154] Rejecting the argument, the court noted that there "can be a causal connection between an employment-related contact in the home by an unfit or dangerous employee and an injury inflicted on the occupant during a later, non-employment related entry into the home."[155]

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31. In rejecting this argument, the court stated that imposing liability based upon such "would be tantamount to holding that there is no longer any proximate causation requirement in negligent employment actions . . . ." *Id.* at 131.

[149] *Id.*

[150] *Id.* at 132 (Deen, P.J., concurring). The plaintiff had alleged that if the employer had required the employee to undergo psychological tests or periodic interviews, the employer would have had knowledge of the employee's dangerous propensities. *Id.* at 131. However, the court refused to impose liability upon the employer for negligent hiring and retention due to the employer's failure to require such, particularly since the employee had no history of criminal or dangerous propensities and no complaints had been received from customers over a lengthy employment relationship. *Id.*

[151] 583 So. 2d 744 (Fla. Dist. Ct. App. 1991).

[152] *Tallahassee Furniture Co.*, 593 So. 2d at 748. The plaintiff brought a claim for negligent hiring in addition to negligent retention. *Id.* at 750. Even though the job required entering the residences of customers, the employee was not interviewed and did not complete an application form. *Id.* at 748. Also, the employer did not conduct any background investigation or request references from the employee. *Id.* Such an investigation would have revealed that the employee had a juvenile and adult criminal record. *Id.* at 749.

[153] *Id.* at 754.

[154] *Id.* at 755.

[155] *Id.*

3. Negligent Supervision

While the bulk of Mississippi negligent supervision cases focuses on the supervision of children or students,[156] other jurisdictions have expanded the tort of negligent supervision to include workplace violence situations.[157] The tort of negligent supervision has been described as a situation in which "[a] person conducting an activity through servants or other agents is subject to liability for harm resulting from his conduct if he is negligent or reckless . . . in the supervision of the activity . . . ."[158] To succeed with an action for negligent supervision, there must be a wrongful act or underlying tort committed by the employee.[159] Claims of negligent supervision are frequently seen in the employment context as pendent claims in sexual harassment suits.[160] Often the saving grace for employers is that they cannot be liable under negligent supervision for an off-duty action of an employee as employers do not have a duty to supervise employees when they are not working.[161]

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[156] Williamson v. Daniels, 748 So. 2d 754, 759 (Miss. 1999) (discussing parent's negligent supervision of child). In the educational setting, the conventional elements of negligence are required to hold a school liable for inadequate supervision. Summers v. St. Andrew's Episcopal Sch., Inc., 759 So. 2d 1203, 1213 (Miss. 2000); *accord* Garrett v. Northwest Miss. Junior Coll., 674 So. 2d 1, 2 (Miss. 1996) (supervising student using dangerous equipment).

[157] *See, e.g.,* Am. Auto. Auction, Inc. v. Titsworth, 730 S.W.2d 499, 501 (Ark. 1987) (holding employer had duty to exercise reasonable care to avoid harm to patrons by supervising forcible ejection of patron); Rockwell v. Sun Harbor Budget Suites, 925 P.2d 1175, 1182 (Nev. 1996) (allowing question of whether employer was liable for negligent supervision of security guard who killed tenant to survive employer's summary judgment motion).

[158] Haverly v. Kaytec, Inc., 738 A.2d 86, 91 (Vt. 1999) (quoting RESTATEMENT (SECOND) OF AGENCY § 213 (1958)).

[159] *Haverly*, 738 A.2d at 91.

[160] *E.g.,* Hays v. Patton-Tully Transp., 844 F. Supp. 1221, 1222 (W.D. Tenn. 1993).

[161] Williams v. United States Fid. & Guar. Co., 854 F.2d 106, 109 (5th Cir. 1988) (citing RESTATEMENT (SECOND) OF TORTS § 317 (1994) which excludes employer's duty to supervise employees unless employee is using employer's chattel)).

4. Negligent Entrustment

The Mississippi Supreme Court has routinely followed the Restatement of Torts in defining the cause of action of negligent entrustment.[162] The Restatement provides that

> [o]ne who supplies directly or through a third person a chattel for the use of another whom the supplier knows or from facts known to him should know to be likely because of his youth, inexperience or otherwise, to use it in a manner involving unreasonable risk of bodily harm to himself and others whom the supplier should expect to share in, or be in the vicinity of its use, is subject to liability for bodily harm caused thereby to them.[163]

In order for an employer to be liable for negligent entrustment, the employee must first be found to be negligent.[164]

While Mississippi negligent entrustment cases primarily involve entrustment of an automobile,[165] the same principles could apply in a workplace violence scenario where the employ-

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[162] Lovett Motor Co. v. Walley, 64 So. 2d 370, 374-77 (Miss. 1953).

[163] *Lovett Motor Co.*, 64 So. 2d at 393 (citation omitted); *see, e.g.,* Sligh v. First Nat'l Bank of Holmes County, 735 So. 2d 963, 969 (Miss. 1999) (quoting Restatement but cautioning that negligent entrustment does not apply where defendant had no right to control chattel); Petermann v. Gary, 49 So. 2d 828, 830-31 (Miss. 1951) (applying Restatement to find defendants guilty of negligence where they knew or should have known operator of truck "habitually and customarily drank intoxicating liquors, and when under the influence of intoxicating liquors was a reckless and incompetent driver, and that he was likely to drive the truck while under the influence of intoxicating liquors and to cause injury and bodily harm to other persons using the highway"); Sharp v. Odom, 743 So. 2d 425, 430 (Miss. Ct. App. 1999) (relying upon RESTATEMENT (SECOND) OF TORTS § 390 (1994)). The Restatement further provides that "[t]he principal may be negligent because he has reason to know that the servant or other agent, because of his qualities, is likely to harm others in view of the work or instrumentalities entrusted to him." RESTATEMENT (SECOND) OF AGENCY § 213 cmt. d (1958).

[164] Freeman v. Lester Coggins Trucking, Inc., 771 F.2d 860, 861 n.1 (5th Cir. 1985) (citations omitted).

[165] *See, e.g.,* Hood v. Dealers Transp. Co., 459 F. Supp. 684, 685-86 (N.D. Miss. 1978) (stressing liability for negligent entrustment of vehicle can only occur by combination of negligent entrustment and negligent act by person entrusted with vehicle); Slaughter v. Holsomback, 147 So. 318, 322 (Miss. 1933) (examining negligent entrustment where automobile is loaned to habitual drunkard).

er would be liable for damages resulting from the actions of an employee entrusted with a chattel. In an Illinois case involving negligent entrustment of a truck with a sleeping compartment to a driver with sex-related convictions and who had been arrested for sex-related crimes against hitchhikers while driving for a previous employer, the court found that the employer had a duty to determine, based upon the employee's background, whether the employee would be a "fit employee."[166] However, whether the employer used due care was a jury question.[167]

5. *Failure to Train and Negligent Training*

In the wake of workplace violence, employers may face liability claims for the failure to train managers or employees in how to identify signs of impending violence or how to react in potentially violent situations. While there currently exists no mandatory requirement for workplace training on the specific issue of violence, OSHA's "general duty" language strongly suggests that such training must occur.

OSHA promulgates dual responsibilities on employers with respect to workplace violence. The "general duty" clause requires that employers provide a safe and healthful workplace.[168] Expanded through regulations promulgated under section 6 of the Act, the "general duty" also creates an employer duty to protect employees from "feasibly preventable" hazards.[169] These hazards have been found to include criminal violence in the workplace,[170] suggesting a number of pre-

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[166] Malorney v. B & L Motor Freight, Inc., 496 N.E.2d 1086, 1087-88 (Ill. 1986). Based upon a lack of evidence in the record, the court rejected the employer's public policy defense that the expense to conduct criminal records checks of all applicants was unduly expensive and burdensome. *Malorney*, 496 N.E.2d at 1089. However, employers should note that some courts may find evidence of the difficulty or expense of background investigations relevant as to the reasonableness of the inquiry in a case for negligent hiring. Garcia v. Duffy, 492 So. 2d 435, 441 (Fla. Dist. Ct. App. 1986).

[167] *Malorney*, 496 N.E.2d at 1089.

[168] The Occupational Safety and Health Act of 1970, 29 U.S.C. § 654(a) (1994), mandates that a workplace be "free from recognized hazards that . . . are likely to cause death or serious physical harm to his employees."

[169] Champlin Petroleum Co. v. OSHARC, 593 F.2d 637, 640 (5th Cir. 1979).

[170] Jonathan A. Segal, *When Charles Manson Comes to the Workplace*, HR

ventive measures should be taken by employers to remain in compliance with OSHA.

What is required of an employer will vary on the facts of the situation. Options, however, certainly include the requirement of training in areas such as conflict resolution, nonviolent reactions, recognition of warning signs and response procedures.[171] In addition, state guidelines may require training, and common law liabilities also suggest training as a fundamental defense to negligence claims.[172]

The Fifth Circuit Court of Appeals has implicitly recognized the "negligent training" tort, holding that an insurer has a duty to defend an employer who is sued for negligent training as a result of acts of sexual molestation by one of its employees.[173] Although the case was limited to the issue of coverage under an insurance policy and thus did not address the type or scope of training implicated by the issue of workplace violence, it clearly suggests that relevant training is a strong factor in the defense of claims of negligent hiring or the newer tort, negligent training.

Management and employee training is a primary tool in equipping workers to recognize signs of impending violence. In addition, it arms workers with skills to defuse volatile situations and alerts them to the proper procedures in the face of sudden violence. Such training is discussed at a later point in this article as a primary tool for prevention and response.

6. Negligent Licensing

Another area of potential negligence liability for employers with licensing authority is negligent licensing. If an entity chooses to license and regulate an area, a duty to exercise rea-

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MAGAZINE, June 1994, at 33.

[171] Terry S. Boone, *Violence in the Workplace and the New Right To Carry Gun Law—What Employers Need to Know*, 37 S. TEX. L. REV. 873, 876 (June 1996).

[172] Garry G. Mathiason & Mark A. de Bernardo, *The Emerging Law of Training*, 45 FED. LAW. 24, 32 (1998).

[173] Evangelical Lutheran Church in Am. v. Atl. Mut. Ins. Co., 169 F.3d 947, 952-51 (5th Cir. 1999).

sonable care in doing so follows.[174] Often, the duty to license is deemed to invoke corresponding duties of investigating and monitoring.[175] Investigations in particular have been scrutinized, as one court has said "[i]ncompetent or haphazard licensing investigations contribute to problems and are morally blameworthy."[176] A seemingly favorite target for negligent licensing claims are those agencies in a position to protect children such as those that license day-care centers[177] and foster parents.[178]

7. Failure to Warn and Misrepresentations

After obtaining knowledge of the violent propensities of an employee, employers are presented with a difficult dilemma when they are contacted for references or recommendations concerning past or present employees. Further complicating matters is determining what, if any, information should be shared with other employees. Based upon precisely the information given by the employer, if any, the employer may be subject to liability for failure to warn, negligent misrepresentation or fraudulent misrepresentation. On the other hand, if the employer is too forthcoming with information he may face liability to the violent employee on the grounds of defamation or invasion of privacy.[179]

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[174] R.E. v. Alaska, 878 P.2d 1341, 1347 (Alaska 1994).

[175] Washoe County v. Transcon. Ins. Co., 878 P.2d 306, 308 n.3 (Nev. 1994).

[176] *R.E.*, 878 P.2d at 1347.

[177] *See, e.g.*, Phillips v. Thomas, 555 So. 2d 81, 83-86 (Ala. 1989) (examining sovereign immunity where negligent licensing of day-care center was alleged by parents of injured child); *R.E.*, 878 P.2d at 1347 (finding duty owed by state to patrons of licensed day-care facilities); *Washoe County*, 878 P.2d at 307-09 (discussing indemnification for county that settled with parents of sexually abused children who brought suit alleging negligent licensing of day-care center).

[178] Rourk v. State, 821 P.2d 273, 280 (Ariz. Ct. App. 1991) (finding sufficient evidence that state was grossly negligent in licensing foster parents without adequate investigation).

[179] *See infra* notes 206-23 and accompanying text.

a. Failure to Warn

In other contexts such as dangerous machinery causing physical injury, Mississippi has long held that the employer has a duty to warn and instruct employees "as to defects or dangers of which he knows, or ought in the exercise of reasonable care and diligence to know, and of which the servant has no knowledge, actual or constructive."[180] In applying similar principles to workplace violence, other jurisdictions have found that employers may have a duty to warn.[181] In *Duffy v. City of Oceanside*,[182] a parolee convicted for rape, kidnapping and sexual assault was hired by the city after serving time in prison and in the state mental hospital.[183] Subsequently, a co-employee reported to her supervisors that the parolee was sexually harassing her.[184] The two employees later developed a social relationship which was known to the employer.[185] At no time did the employer warn the co-employee of the parolee's criminal history or violent propensities.[186] After the parolee kidnapped and killed the co-employee, her heirs brought suit against the city for failure to warn, and the California court found that the employer may be liable for such.[187]

Although courts have been careful to note that a person does not generally owe a duty to control another or to warn others who may be endangered, "special relationships" are

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[180] Cole v. Tullos, 90 So. 2d 32, 36 (Miss. 1956) (citing 56 C.J.S. *Master and Servant* §§ 284, 286; 35 AM. JUR. *Master and Servant* §§ 145-52 (1941)); *see, e.g.*, Gordon v. Niagara Mach. & Tool Works, 506 F.2d 419, 422-23 (5th Cir. 1974); Bosarge v. Gaines, 93 F.2d 800, 801 (5th Cir. 1938).

[181] *E.g.*, Tarasoff v. Regents of the Univ. of Cal., 551 P.2d 334, 348 (Cal. 1976) (finding employer of psychotherapists may be liable for failure to warn of mental patient's violent propensities). *See generally* John K. Ziegler, *Employment Law—An Employer's Duty to Third Parties When Giving Employment Recommendations*—Davis v. Board of County Commissioners of Dona Ana County, 30 N.M. L. REV. 307 (2000).

[182] 179 Cal. App. 3d 666 (1986).

[183] *Duffy*, 179 Cal. App. 3d at 669.

[184] *Id.*

[185] *Id.*

[186] *Id.*

[187] *Id.* at 675. Whether the employer acted reasonably in failing to warn the co-employee was a question of fact. *Id.*

often created which may impose such a duty.[188] However, an employer may be absolved of liability if it is proven that the employer had no actual or constructive knowledge of an employee's propensities.[189]

Perhaps one of the more worrisome cases in this particular area for employers is the decision of *Coath v. Jones*.[190] In *Coath,* the plaintiff was raped in her home by a man who had previously been to the plaintiff's home on business for his employer.[191] Even though the employment relationship was no longer in existence at the time of the rape, the plaintiff sued the former employer, and the court found that "where the employer has created a special relationship whereby his customers admit his employees into their homes, then the employer may be required to give notice or warning to the customer that the employee is no longer employed."[192] Accordingly, the termination of an employment relationship with a violent employee may not necessarily terminate the employer's liability for future acts.

b. Misrepresentations

The basis of the cause of action of negligent misrepresentation is a lack of care.[193] The claim has the following elements: (1) the misrepresentation or omission of a fact; (2) said misrepresentation or omission is material or significant; (3) the failure to exercise reasonable care; (4) reasonable reliance upon the misrepresentation or omission; and (5) damages suffered as a direct and proximate result of such reliance.[194] Accordingly,

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[188] Koepke v. Loo, 23 Cal. Rptr. 2d 34, 38 (Cal. Ct. App. 1993).

[189] *Compare* Wood v. Astleford, 412 N.W.2d 753, 757 (Minn. Ct. App. 1987) (holding no duty to warn where no evidence employer knew or should have known of employee's violent propensities), *with* Senger v. United States, 103 F.3d 1437, 1443 (9th Cir. 1996) (finding summary judgment could not be granted for employer where employer had actual or constructive knowledge of employee's violent propensities).

[190] 419 A.2d 1249 (Penn. 1980).

[191] *Coath*, 419 A.2d at 1250.

[192] *Id.*

[193] Spragins v. Sunburst Bank, 605 So. 2d 777, 780 (Miss. 1992).

[194] Berkline Corp. v. Bank of Miss., 453 So. 2d 699, 702 (Miss. 1984); *see, e.g.,* Clark v. St. Dominic-Jackson Mem. Hosp., 660 So. 2d 970, 974 (Miss. 1995) (quot-

the expression of an opinion is not actionable.[195]

Similarly, a claim may be made for fraudulent or intentional misrepresentation.[196] In order to sustain a fraudulent misrepresentation claim, the plaintiff must prove the following: (1) a representation; (2) the falsity of the representation; (3) the materiality of the representation; (4) the speaker's awareness of the falsity of the representation; (5) the speaker's intent that the hearer should act on the representation and in the manner reasonably contemplated; (6) the hearer's ignorance of the falsity of the representation; (7) the hearer's reliance upon the representation as truth; (8) the hearer's right to rely upon the representation; and (9) the consequent and proximate injury.[197] As opposed to the lack of care found in negligent misrepresentation, the basis for a claim of fraudulent misrepresentation is a lack of honesty.[198]

An employer electing to give a recommendation must do so with reasonable care and disclose enough information so that the recommendation is not misleading.[199] In the landmark case of *Randi W. v. Muroc Joint Unified School District*,[200] the court held that liability could be imposed upon an employer based upon the failure to use reasonable care in the recommen-

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ing RESTATEMENT (SECOND) OF TORTS § 311 (1965)). The *Berkline* court found this tort analogous to the rule of promissory estoppel and doctrine of equitable estoppel. *Berkline*, 453 So. 2d at 702.

[195] White v. Hancock Bank, 477 So. 2d 265, 270 (Miss. 1985). The first element required for a negligent misrepresentation claim is the misrepresentation or omission of a fact. Bank of Shaw v. Posey, 573 So. 2d 1355, 1360 (Miss. 1990); *White*, 477 So. 2d at 270. Furthermore, it must be a past or present fact and not a promise of future conduct. *Spragins*, 605 So. 2d at 780.

[196] Negligent misrepresentation should be distinguished from a claim for fraudulent misrepresentation, which has different elements and must be proved by clear and convincing evidence. Levens v. Campbell, 733 So. 2d 753, 761 (Miss. 1999).

[197] Champion Int'l Corp. v. First Nat'l Bank, 642 F. Supp. 237, 240 (S.D. Miss. 1986); *see* First Money, Inc. v. Frisby, 369 So. 2d 746, 750 (Miss. 1979).

[198] *Posey*, 573 So. 2d at 1360 (quoting *First Money, Inc.*, 369 So. 2d at 750).

[199] Davis v. Bd. of County Comm'rs, 987 P.2d 1172, 1180 (N.M. Ct. App. 1999). Public policy encourages complete disclosure by employers of non-confidential information. *Davis*, 987 P.2d at 1181. In order to motivate employers to do such, legal commentators have promoted legislation to grant the employer's immunity for disclosure. *Id.*

[200] 929 P.2d 582 (Cal. 1997).

dations of a former employee.[201] The glowing letters of recommendation, which failed to disclose information about disciplinary action taken against the former employee resulting from sexual harassment and his resignation under pressure due to sexual misconduct charges, were deemed to constitute an "affirmative misrepresentation."[202] In examining the issue of recommendations, the court determined that one giving a letter of recommendation "owes to third persons a duty not to misrepresent the facts in describing the qualifications and character of a former employee, if making these misrepresentations would present a substantial, foreseeable risk of physical injury to the third persons."[203] Therefore, when the former employer elected to provide some information, it was then obligated to disclose all other facts materially qualifying the facts disclosed.[204] Otherwise, "half of the truth may obviously amount to a lie, if it is understood to be the whole."[205]

III. Liability of an Employer to the Perpetrator

In addition to the employer's liability exposure to third parties, the employer may also face liability to the perpetrator. Such liability may be founded in state or federal law and may arise prior to an occurrence of workplace violence.

A. Defamation and Invasion of Privacy

Upon initial examination, the causes of action of defamation and invasion of privacy can be troublesome for employers who are laboring to balance safety and privacy of employees.

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[201] *Randi W.*, 929 P.2d at 591. *But see* Neptuno Treuhand-Und Verwaltungsgesellschaft MBH v. Arbor, 692 N.E.2d 812, 819-20 (Ill. 1998) (declining to follow *Randi W.*); Moore v. St. Joseph Nursing Home, Inc., 459 N.W.2d 100, 102 (Mich. Ct. App. 1990) (rejecting proposition that employer had duty to disclose employee's violent propensities to prospective employers and stating that such duty should come from legislature not court).

[202] *Randi W.*, 929 P.2d at 584. The prospective employer, another school district, relied upon the letters of recommendation in its decision to hire. *Id.* Subsequently, the employee sexually assaulted a student in the new school district. *Id.*

[203] *Id.* at 591.

[204] *Id.*

[205] *Id.* (quoting W. Page Keeton et al., Prosser & Keeton on the Law of Torts § 106, at 738 (5th ed. 1984)).

The essence of defamation is injury to one's reputation,[206] and the elements required for a private plaintiff[207] are as follows: "(1) a false and defamatory statement concerning the plaintiff; (2) an unprivileged publication to a third party; (3) fault amounting to at least negligence on the part of the publisher; and (4) either actionability of the statement irrespective of special harm or the existence of special harm caused by the publication."[208] A defamatory statement is "[a]ny written or printed language which tends to injure one's reputation, and thereby expose him to public hatred, contempt or ridicule, degrade him in society, lessen him in public esteem or lower him in the confidence of the community."[209] With regard to privacy, Mississippi has explicitly recognized three viable actions[210] for the common law right of privacy which include portrayal of the plaintiff in a false light,[211] appropriation of the plaintiff's name or likeness for commercial purposes and public disclosure of private facts regarding the plaintiff.[212] The claim most com-

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[206] Although not thoroughly developed in Mississippi law, the cause of action of tortious interference with prospective economic relations was recognized by the Mississippi Supreme Court in 1910 in *Wesley v. Native Lumber Co.*, 53 So. 346, 347 (Miss. 1910). Protected relations include, among others, obtaining employment. Cenac v. Murry, 609 So. 2d 1257, 1270 (Miss. 1992). It has been argued to apply where an employer's defamatory statements or negative recommendation preclude the employee from future employment. *Cenac*, 609 So. 2d at 1270.

[207] A plaintiff who is a public figure must prove by clear and convincing evidence that the defamatory statement was made with actual malice. Journal Publ'g Co. v. McCullough, 743 So. 2d 352, 359-60 (Miss. 1999).

[208] *Journal Publ'g Co.*, 743 So. 2d at 359 (citations omitted).

[209] *Id.*

[210] The viability of a fourth cause of action arising out of the "intrusion upon the solitude or seclusion of another" is plausible. Prescott v. Bay St. Louis Newspapers, Inc., 497 So. 2d 77, 79 (Miss. 1986); Candebat v. Flanagan, 487 So. 2d 207, 209 (Miss. 1986).

[211] *Prescott*, 497 So. 2d at 79. The Mississippi Supreme Court, quoting from the Restatement, defined the action of portrayal of plaintiff in a false light as

> [o]ne who gives publicity to a matter concerning another that places the other before the public in a false light is subject to liability to the other for invasion of privacy, if (a) the false light in which the other was placed would be highly offensive to a reasonable a reasonable person, and (b) the actor had knowledge of or acted in reckless disregard as to the falsity of the publicized matter and the false light in which the other would be placed.

Id. (quoting RESTATEMENT (SECOND) OF TORTS § 652E (1976)).

[212] Young v. Jackson, 572 So. 2d 378, 382 (Miss. 1990). Specifically, liability

monly raised in employment settings is the public disclosure of private facts.

In cases against employers, plaintiffs have often fallen short of a prima facie defamatory case due to the employer's lack of publication to a third party. However, the doctrine of self-defamation may be applicable where the victim of a defamatory statement publishes the statement to others, such as prospective employers, and such publication has been held to be sufficient to meet the defamation publication requirement by some courts.[213] The doctrine is an exception to the general rule of defamation that the defamatory statement must be spoken by someone other than the plaintiff.[214] The majority of states have rejected the doctrine of self-defamation.[215]

Even if a plaintiff is able to establish a prima facie case, employers can often successfully defend defamation and invasion of privacy actions. The first line of defense is frequently that the alleged defamatory statement is true, as truth is an absolute defense to a defamatory action.[216] Another viable defense for employers is the qualified privilege afforded to employer-employee communications regarding personnel matters. In *Killebrew v. Jackson City Lines*,[217] the Mississippi Supreme Court stated as follows:

> The law guards jealously the right to the enjoyment of a good reputation, but public policy, good morals, the interests of society, and sound business demand that an employer, or his representative, be permitted to discuss freely with an

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may occur where "[o]ne gives publicity to a matter concerning the private life of another . . . if the matter publicized is of a kind that (a) would be offensive to a reasonable person, and (b) is not of legitimate concern to the public." *Young*, 572 So. 2d at 382 (quoting RESTATEMENT (SECOND) OF TORTS § 652D (1977)).

[213] Olivieri v. Rodriguez, 122 F.3d 406, 408 (7th Cir. 1997).

[214] Johnson v. Overnite Transp. Co., 19 F.3d 392, 392 n.1 (8th Cir. 1994).

[215] *Olivieri*, 122 F.3d at 409. *But see* Arthaud v. Mut. of Omaha Ins. Co., 170 F.3d 860, 862 (8th Cir. 1999) (enumerating six elements required by Missouri law for self-defamation action).

[216] However, it must be the whole truth. Eason v. Fed. Broad. Co., 697 So. 2d 435, 437 (Miss. 1997). If an underlying implication is false, then the entire statement is considered false. Eselin-Bullock & Assocs. Ins. Agency, Inc. v. Nat'l Gen. Ins. Co., 604 So. 2d 236, 241 (Miss. 1992).

[217] 82 So. 2d 648 (Miss. 1955).

> employee, or his chosen representative, charges made against the employee affecting the latter's employment. On such occasions there is a qualified privilege, and statements made within the scope of the privilege, in good faith and without malice, are not actionable. The truth or falsity of the communication is not involved so long as there is no bad faith or malice.[218]

When the employer establishes the privilege, statements are not actionable, absent bad faith or malice, if the statements were limited to "those persons who have a legitimate and direct interest in the subject matter."[219] However, the privilege is qualified, and it may be destroyed in two ways: (1) malice and (2) publication made beyond the permissible scope.[220] Those within the permissible scope will, of course, vary based upon the circumstances; previous cases have included co-employees, close family members and shopping companions within the scope.[221] Statements can safely be given to law enforcement,[222] and employers also have some protection from liability for comments made to the Mississippi Employment Security Commission.[223]

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[218] *Killebrew*, 82 So. 2d at 650; *see also* La. Oil Corp. v. Renno, 157 So. 705, 708 (Miss. 1934) (defining scope of privilege). The privilege is also applicable to actions for invasion of privacy. Young v. Jackson, 572 So. 2d 378, 383 (Miss. 1990).

[219] Benson v. Hall, 339 So. 2d 570, 573 (Miss. 1976).

[220] *Benson*, 339 So. 2d at 573.

[221] Gordon v. Tenneco Retail Serv. Co., 666 F. Supp. 908, 911-12 (N.D. Miss. 1987); *accord* Garziano v. E.I. DuPont De Nemours & Co., 818 F.2d 380, 387 (5th Cir. 1987) (stating co-employees have legitimate interest in co-employee's termination due to sexual harassment incident); Gardner v. Standard Oil Co., 175 So. 203, 205 (Miss. 1937) (holding statement to co-employees that former employee was fired for theft privileged).

[222] Downtown Grill, Inc. v. Connell, 721 So. 2d 1113, 1119 (Miss. 1998) (quoting J.C. Penney Co. v. Cox, 148 So. 2d 679, 683 (Miss. 1963)).

[223] MISS. CODE ANN. § 71-5-131 (2000).

B. Wrongful Discharge

Employers should also be wary of being sued by an employee who is terminated in an effort to prevent workplace violence. Since 1858, Mississippi has followed the common law rule of employment at-will, which allows an employment relationship for an indefinite term to be terminated at the will of either party.[224] As applied, this theory allows the employer and the employee to terminate the relationship for "a good reason, a wrong reason, or no reason."[225] In addition, the Mississippi Court of Appeals has signaled that it is cognizant of an employer's workplace violence concerns. In *Hux v. Mississippi Employment Security Commission*,[226] the court upheld the denial of unemployment benefits and noted that the employer was justifiably concerned with the prevention of workplace violence, among other problems.[227]

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[224] Butler v. Smith & Tharpe, 35 Miss. 457, 464 (1858); *accord* Robinson v. Coastal Family Health Ctr., Inc., 756 F. Supp. 958, 960-61 (S.D. Miss. 1990) (allowing employee hired for specific time to pursue breach of contract action since at-will action inapplicable); Perry v. Sears, Roebuck & Co., 508 So. 2d 1086 (Miss. 1987); Shaw v. Burchfield, 481 So. 2d 247, 253-54 (Miss. 1985).

[225] *Butler*, 35 Miss. at 464. Although an unspoken assumption, the reason cannot be a legally impermissible one. *See, e.g.*, Whiting v. Jackson State Univ., 616 F.2d 116, 122 (5th Cir. 1980) (stating employee cannot be terminated on basis of race). The Mississippi Supreme Court has carved out exceptions to the employment at-will doctrine. *See, e.g.*, Southwest Miss. Reg'l Med. Ctr. v. Lawrence, 684 So. 2d 1257 (Miss. 1996) (finding employee handbook created implied contract of employment); McArn v. Allied Bruce Terminix Co., 626 So. 2d 603, 607 (Miss. 1993) (discussing public policy exception to at-will doctrine and signaling "at least two" exceptions: termination for refusing to participate in illegal activity and termination for reporting such); Robinson v. Bd. of Trs. of E. Cent. Junior Coll., 477 So. 2d 1352, 1353 (Miss. 1985) (holding employee handbook could alter status of employment relationship); *see also* Willard v. Paracelsus Health Care Corp., 681 So. 2d 539, 543 (Miss. 1996) (allowing independent tort and punitive damages for retaliatory discharge for refusing to participate in illegal act). *See generally*, Debbie Ho, *Employment Law—Exceptions to the At-Will Doctrine—The Adoption of the Public Policy Exception in Two Specific Situations Could Signal the Adoption of Additional Exceptions to the Doctrine*, 64 MISS. L.J. 257 (1994).

[226] 749 So. 2d 1225 (Miss. Ct. App. 1999).

[227] *Hux*, 749 So. 2d at 1225. The terminated employee also failed to stop contact with a co-employee despite instructions to do so. *Id.*

C. Title VII of the Civil Rights Act of 1964

In the pursuit of a stable, nonviolent workplace, an employer must temper pre-employment screening methods to assure compliance with Title VII of the Civil Rights Act of 1964. Title VII prohibits an employer from refusing employment or classifying employees on the basis of race, color, religion, sex or national origin.[228] In the context of pre-employment screening procedures, Title VII dictates that any such practices conform strictly with the law and not facially or through disparate impact, discriminate on the basis of one of the protected classes. To be safe, the employer who uses practices such as background checks, reference checks, consumer reports, and the like should safeguard against even tangential impact of Title VII.[229] Such an ongoing analysis is best done through regular monitoring of the impact that background check procedures are having on the employer's work force composition.[230]

With post-job references, the employer giving the reference information may run afoul of Title VII by providing a negative reference for discriminatory reasons or in retaliation against a current or former employee.[231]

D. The Fair Credit Reporting Act

The Fair Credit Reporting Act (FCRA) regulates consumer credit reporting agencies and sets forth stringent requirements on the use of consumer reporting information to make job decisions.[232] The definition of consumer report may be interpreted so broadly as to include reference checking in the pre-employment process,[233] since the definition extends to the type of in-

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[228] 42 U.S.C. §§ 2000e to -17 (1994 & Supp. 1999).

[229] Rochelle B. Ecker, *To Catch a Thief: The Private Employer's Guide to Getting and Keeping an Honest Employee*, 63 UMKC L. REV. 251, 278 (1994).

[230] Debbie Rodman Sandler, *Due Diligence for Employers Conducting Background Checks*, 20 PA. L. WKLY. 1530 (Nov. 17, 1997).

[231] 16 No. 24 EMPALERT 1, *Truth or Consequences: Legal and Practical Aspects of Reference Checking* (Nov. 1999).

[232] John R. Paddock, *New Limitations and Requirements in Reviewing Applicants' and Employees' Credit Records*, 27 COLO. LAW. 95 (July 1998).

[233] *Id.*

formation generally associated with a background investigation.[234]

Employers who desire to use outside consumer credit reporting agencies, especially where the inquiry will include interviews, should carefully construct the inquiry around clearly job-related criteria, should carefully monitor both the questions and their impact on the workforce to assure non-discriminatory application and should only proceed in careful compliance with the FCRA.

E. The Americans with Disabilities Act

A particularly thorny issue confronts employers who are concerned about applicants or employees who pose a potential threat in the workforce, the likely cause of which is mental illness. The Americans with Disabilities Act (ADA) was passed by Congress in 1990 to address widespread discrimination against persons with disabilities.[235] It augments the Rehabilitation Act of 1973, which bars discrimination by the federal government, federal contractors and federally funded programs.[236] The ADA functions more broadly than the Rehabilitation Act as it applies to all employers with fifteen or more employees except the federal government and tax exempt private member clubs.

For purposes of definition, the ADA applies to a broad range of physical and mental conditions. Interpretative regulations define a physical or mental impairment as "any physiological disorder, or condition . . . affecting one or more . . . body systems . . . or (any) mental or psychological disorder, such as mental retardation, organic brain syndrome, emotional or mental illness, and specific learning disabilities."[237] If applicable, an individual entitled to protections of the ADA is generally entitled to a reasonable accommodation to perform a

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[234] 15 U.S.C. § 1681 (1994 & Supp. 1999).

[235] 42 U.S.C. § 12111 (1994).

[236] 29 U.S.C. § 701 (1994 & Supp. 1999).

[237] 29 C.F.R. § 1630.2(h) (2000); Karen Dill Danforth, *Reading Reasonableness Out of the ADA: Responding to Threats by Employees with Mental Illness Following Palmer*, 85 VA. L. REV. 661, 666 (May 1999).

job provided that the accommodation does not create an "undue hardship."[238]

An employer faced with accommodating a disability may also plead a defense of "direct threat"[239] since the overall definition of qualified to perform the job includes the "requirement that an individual does not pose a direct threat to the health or safety of other individuals in the workplace."[240] "Direct threat" may be defined as a "significant risk of substantial harm to the health or safety of the individual or others that cannot be eliminated or reduced by reasonable accommodation."[241] Assessment of the threat is accomplished on an individual case basis and includes issues of severity, duration and likelihood of occurrence.[242]

A disabled employee, even if the disability is a mental one, may be held to the same standard of conduct as non-disabled employees. Thus, where an employee engages in threatening conduct, even where it is caused by mental illness, discipline or termination does not present an issue under the ADA.[243] In the wake of cases like *Palmer v. Circuit Court*, the EEOC has clarified this point by stating that an employer may discipline a disabled individual for violating workplace conduct standards, even when caused by the disability, provided that the standard is clearly job-related and consistent with business necessity.[244] As one court has summarized, "the ADA does not insulate emotional or violent outbursts blamed on an impairment. An employee who is fired because of outbursts at work directed at fellow employees has no ADA claim."[245]

The Fifth Circuit Court of Appeals has addressed the "direct threat" standard, holding that while the employer bears

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[238] 42 U.S.C. § 12112 (1994).

[239] 42 U.S.C. § 12113 (1994).

[240] Danforth, *supra* note 237, at 672.

[241] *Id.*

[242] *Id.*

[243] Palmer v. Circuit Court, 117 F.3d 351, 352 (7th Cir. 1997).

[244] EEOC Enforcement Guidance: *The Americans with Disabilities Act and Psychiatric Disabilities*, Notice No. 915.002, 8 Fair Employment Prac. Manual (BNA) 405:7463 (1977).

[245] Hamilton v. Southwestern Bell Tel. Co., 136 F.3d 1047, 1052 (5th Cir. 1998).

the burden of proving that an employee is a direct threat, the determination is one of fact, best left to the trier of fact to weigh and resolve.[246] Moreover, where reasonable workplace policies such as substance abuse policies are involved, courts have held that an employer may only need to prove a reasonable business necessity rather than the more stringent "direct threat."[247]

Mental conditions which fall under the ADA are complex and often difficult for an employer to handle. Many such conditions are outwardly recognizable only by behavior. Where that behavior poses a threat of violence or actually results in violent or emotional outbursts, an employer should proceed immediately to assess the potential harm and to take action. Decisions such as those discussed here may cause an employer to walk a delicate balance between the rights of the employee and the rights of those with whom the employee comes in contact. Courts, however, have shown a strong tendency to find for the employer where clear evidence of a "direct threat" is present.

IV. Practical Pre-Employment Preventive Measures

An ounce of prevention really is worth at least a pound of cure in the realm of workplace violence. Under Mississippi law, a person has a duty to "exercise his senses and intelligence in his actions in order to avoid injury to others, and where a situation suggests investigation and inspection in order that its dangers may fully appear, the duty to make such investigation and inspection is imposed by law."[248] Consequently, this portion of the article will address concrete pre-employment practices which lessen the chance of workplace violence and increase the level of effective response in the event it does occur.[249]

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[246] Rizzo v. Children's World Learning Ctrs., Inc., 84 F.3d. 758, 764 (5th Cir. 1996).

[247] EEOC v. Exxon Corp., 203 F.3d 871, 875 (5th Cir. 2000).

[248] Brunt v. Chi. Mill & Lumber Co., 139 So. 2d 380, 384 (Miss. 1962).

[249] The discussion of strategies for prevention is by no means an exhaustive listing. It does provide a core of basic defensive actions, however, which may be taken by an employer to reduce the likelihood of volatile behavior in the workplace.

A. Drug and Alcohol Testing

Use of illegal drugs and alcohol and abuse of prescription drugs cost American businesses over $60 billion a year.[250] The Drug-Free Workplace Act of 1988[251] imposes obligations on employers who maintain federal contracts of over $100,000 and on other groups who receive federal grant money. It further requires that employers have and follow a specific plan for maintaining a drug free workplace. In addition, most employees in the transportation industry submit to mandatory drug testing under the Omnibus Transportation Employee Testing Act.[252]

With respect to identifying potentially violent employees before they are hired, drug testing of applicants is permitted, provided they have notice of the testing policy. The law is not as permissive, however, when applied to current employees. There, the testing must be pursuant to a constitutional scheme. Testing on reasonable suspicion is likely to be upheld[253] and random, suspicionless testing of certain employees is permissible, depending on state law.[254]

Pursuant to state statute, public and private employers in Mississippi may elect to implement alcohol and substance testing up to and including random, suspicionless testing of current employees.[255] An employer elects to test by publishing written employee and applicant notices which adequately explain the grounds for testing, and how the employer will deal with policy violations.[256]

Key to any employer's decision to test are the following considerations: (1) A written policy must be maintained which complies with all requirements of the statutes, and employees

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[250] Louise Ann Fernandez, *Work Place Claims: Guiding Employers and Employees Safety In and Out of the Revolving Door*, 614 PLI/LIT 725, 763 (1999).

[251] 41 U.S.C. §§ 701-707 (1994 & Supp. 1999).

[252] 49 C.F.R. § 382 (2000).

[253] Fernandez, *supra* note 250, at 767.

[254] Public employers subject to the requirements of the Fourth Amendment's search and seizure protections are more stringently scrutinized when they attempt random, suspicionless testing. Chandler v. Miller, 520 U.S. 305, 309 (1997).

[255] MISS. CODE ANN. § 71-7-5 (2000).

[256] *Id.* § 71-7-3.

must be given clear notice prior to the adoption of a testing program; (2) An employer must decide when he or she will test. Choices include any or any combination of (a) pre-employment, (b) upon change of job position, (c) randomly, and/or (d) for reasonable suspicion; and (3) An employer must locate and utilize a reputable laboratory capable of sustaining the high standards set by the statutes.

The advantages of a testing program with respect to the prevention and redress of workplace violence include providing the employer with an objective way to learn of substance abuse issues before violence erupts and alerting an employer to circumstances of potential employee risk in a manner which permits the employer to intervene proactively.

B. Background Checks

Background checks, when conducted by persons with special techniques training, are an effective tool in the pre-employment assessment of potential threats. Legal checks and balances on the scope and manner of the check, however, dictate strict compliance with a number of laws. Pursuant to the general caveat that all background information inquiries should center on information relevant to job duties, employers who are filling positions which bear particular aspects of safety, security or the like are permitted to conduct a measure of background information.

Where job positions involve safety, security, client or patient care, fiscal integrity and other "critical" functions, employers will likely want to inquire into criminal history, including convictions of relevant offenses. An employer may determine whether to conduct such an inquiry through: (1) the use of a waiver document and assignment of the full investigation to an inside investigator, (2) interview inquiry to the applicant followed by "check up" procedures by the employer, or (3) the use of an internal affairs type outside investigator.

In Mississippi, a number of state statutes require background investigation of potential employees prior to their hiring. The Mississippi Department of Information Technology Services is required to fingerprint and conduct criminal background checks on candidates who apply for positions of "infor-

mation confidentiality."[257] Similarly, persons or entities delivering broadly defined child care services must submit to a national criminal history record check as well as checks under relevant state hotline registries.[258] In extension of the child protection policy, child care facilities must obtain a current criminal background history on any prospective caregiver.[259] Family child care homes bear like scrutiny.[260] In the educational arena, schools are charged with requiring current criminal records background checks and child abuse registry checks on employees, licensed or unlicensed, hired on or after July 1, 2000.[261]

Employers who use the services of outside consumer reporting agencies to access reports to be used for employment purposes should be alert to the requirements of the Fair Credit Reporting Act (FCRA).[262] With definitions of "consumer report" which include references to character and personal characteristics, the FCRA sets definite requirements, and employers who negligently or willfully fail to comply face stiff penalties. If the report is "investigative" in nature, meaning that it involves interviews of personal acquaintances, the employer must make certain disclosures including notice of the fact and nature of the inquiry as well as notice of the action taken as a result of the information. Experts in the employment field suggest adherence to standard forms and procedures which satisfy the strict notice and disclosure requirements of the FCRA.[263]

Although it is a difficult and frustrating process, employers must be vigilant in assessing past job performance through reference checks and pro-active investigation. National surveys suggest that the need for reference checks is at an all-time

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[257] *Id.* § 25-53-51 (1999).

[258] *Id.* § 43-15-6 (2000).

[259] *Id.* § 43-20-8.

[260] *Id.* § 43-20-57.

[261] *Id.* § 37-9-17 (Supp. 2000).

[262] 15 U.S.C. § 1681 (1994 & Supp. 1999); *see supra* notes 232-34 and accompanying text.

[263] Robert F. Stewart, *Checking Up on Job Applicants and Employees: Federal Limits On Background Investigations*, 158 N.J. LAW. 16 (1994).

high.[264] A national consultant noted in late 1999 that the percentage of applicants embellishing and distorting their resumes rose from 17% in 1979 to 36% in 1997.[265] The following constitute suggestions for accessing past history information:

- Proceed on an executed release and waiver which states the potential scope of the contemplated investigation.
- Focus heavily on "suspicious" breaks or gaps in employment.
- Focus heavily on reasons the individual left previous jobs.
- Focus heavily on previous disciplinary or performance actions.
- Verify claims of education and experience.
- Prepare in advance for reference check calls by outlining questions.
- Focus the reference check on specific information-duties, performance, disciplinary history, and always end with *"Would the person be eligible to be re-hired?"*

All personal references who are contacted for information about an applicant should be asked how long they have known the applicant, in what capacity and whether the reference is based on first hand knowledge. In addition, reference checkers should be cognizant of anti-discrimination laws and their potential application to discriminatory reference practices, on both the side of the questioner and the side of the employer respondent.

C. Strategic Interview Practices

While interview practices are subject to stringent limitations under federal and state anti-discrimination laws, employers should include inquiries designed to explore the applicant's likely reactions to stress and his or her general state of emotional stability.[266] Such inquiries do not promote "yes" or "no"

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[264] Sandler, *supra* note 230.

[265] Wendy Bliss, Speech to the 1999 Society for Human Resource Management.

[266] Employers should bear in mind the careful manner in which pre-employment inquiries which delve into emotional stability will be scrutinized under the Americans with Disabilities Act, 42 U.S.C. § 12101 (1994 & Supp. 1999), since

answers but rather offer the opportunity for the applicant to speak at length about actual situations and his or her responses.

Illustrative of the type inquiries suggested are the following questions:

- Tell me about a time you thought you were treated unfairly by your supervisor. How did you handle it? What did you do or say?
- Have you ever been discharged or disciplined on any job?
- Have you ever been in a fight or argument at work?
- Have you ever been asked to resign a position?
- Have you ever considered leaving a job (or left) as a result of a conflict with a supervisor or co-worker?
- How do you "blow off steam" when you're mad about something?
- What are the three most stressful events you've ever experienced at work and how did you handle them?

Assessments of temperament and stability in an interview setting also suggest the use of multiple interviewers to achieve a balanced look at the person, structured interview questions from applicant to applicant, multiple "rounds" of interviewing before hiring, use of job-specific tests designed to measure reactions and firm hiring criteria as a reference for each applicant.

V. Practical Preventive Measures During Employment

Chief among the duties of executive management is to assure that the day-to-day operational challenges which often co-exist with employee, client and customer emotions are defused and addressed by supervisors who are fully educated, trained and armed to react in a responsible way.

No organization can be ready for the unexpected without attending to its preparation in a methodical, scheduled and incremental manner. Management must locate, develop and

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many mental illnesses are defined as "disabilities" and may not form the basis for direct inquiry.

deliver comprehensive development tools which address issues such as effective communication techniques, skills for defusing conflict in the workplace steady systems of feedback and performance measurement for employees, management of job stress, adaptation to change in the workplace and supportive coaching and counseling practices. Highly evolved organizations do not treat supervisor training lightly. They focus on the development of their leaders through curriculum-based, ongoing, flexible programs.

A. Employee Assistance Programs

A cornerstone of every successful workplace violence prevention plan is the presence of an Employee Assistance Program (EAP). This fact is true because when an organization's employees have problems, the employer has problems, too. In Mississippi, organizations have accessed employee assistance services most commonly as a part of their overall drug and alcohol prevention policies. To date, many public sector agencies have established EAP policies which are administered by third party providers.

Employee "life" problems like alcoholism, emotional difficulties family conflict, substance abuse, legal and financial difficulties and the like take a tremendous toll on the employee's ability to function at work. As an employee loses a sense of control over his or her environment, workplace manifestations may follow. Studies have shown that employees with mental health or substance abuse issues use eight times more medical care, are absent over twice as much as non-compromised employees, and have four times as many workplace accidents.

Organized EAPs provide employees with free (or nearly free), confidential and easily accessible resources while helping an organization to provide a safer work environment, save money and reduce tardiness and absences. In addition, EAPs are visible proof to employees that their employer cares about them as people. This impression often supports an organization's ability to attract and retain good employees.

Questions to be considered in assessing EAP services include scope of services provided, schedule of availability, access

for out-of-town employees, breadth of services and willingness to accept involuntary referrals as well as voluntary referrals.

B. Zero Tolerance and a Written Policy

An organization which intends to communicate zero tolerance for workplace violence will likely desire to implement a written policy. The advantages of this approach include the following: clearly informing employees that the policy will address intimidation, harassment and other inappropriate behavior that threatens or frightens them; encouraging employees to report all incidents; informing employees whom to call; and demonstrating management commitment to deal with reported incidents.[267]

A policy should contain a statement indicating that all employees are responsible for maintaining a safe work environment, that the employer will respond to all reported incidents in an appropriate manner, and that the employer will act in an appropriate manner to stop the behavior. Also, a policy should provide coverage of not only acts of violence, but also harassment, intimidation and other disruptive behavior, and coverage of incidents involving coworkers as well as incidents involving individuals from outside the company perpetrating violence against employees, customers or members of the public in public organizations.

Policies should be brief and simple and should avoid loaded phrases like "zero tolerance" which may create legal complications in the handling of different incidents. Policy drafters should resist the urge to over-define terms like "violence," "disruptive," "harassing," etc., which may make employees less likely to report. Also, where appropriate, such as for state agencies, reference to other supportive policies including statutory prohibitions against weapons on state property should be included.

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[267] Where an organization does not want to formalize such a policy, the details of a plan may still be delivered to employees and the public via memorandum form. Even in the absence of any policy, an organization still has the inherent right to take action against employees who engage in disruptive or threatening behavior.

C. Psychiatric or Psychological Examinations

Employers often wish to assess potential threats through psychological examination, and, thus, questions arise concerning the type, scope and timing of such examinations. In addition, employers may wish to condition an employee's return to the workplace after an incident on a psychological test concerning fitness to return to work. Both types of examination are permissible but must be administered pursuant to stringent guidelines and requirements.

Pre-employment medical tests, such as psychological instruments, implicate the Americans with Disabilities Act and may implicate other classes protected by Title VII as applied. Consistent with the organization's ability to inquire into an applicant's ability to do a particular job, however, employers may require a medical examination after an offer of employment and prior to the commencement of the employment. The employer may condition employment on the results of the test, provided that all employees are subjected to the test and information regarding medical history is treated as confidential and kept in separate medical files which is shared only in serious "as needed" situations.

Employers considering psychological testing should approach the testing with the several safeguards. Notice should be given to applicants, and receipt of a signed waiver form should be obtained. Tests should be independently validated to assure that they request only job-related information, and employers should seek assurance that tests are administered by independent competent sources. Also, employers must pay careful attention to assure that tests do not negatively impact protected classes.

In addition to pre-employment tests, employers may elect, where an employee has been on medical leave related to violent behavior, incident or mental illness with violent tendency, to require a "fitness to return to work" evaluation from a qualified professional. Again, such examinations, while prudent, should be carefully administered to be consistent and focused on "job-related" information, triggered under consistent and defensible criteria, conducted by qualified professionals and carefully and

confidentiality utilized.

VI. Conclusion

The demands of contemporary living continue to place stresses on the American workplace, its workers and its customers. The pace of demand and resulting service impacts will not wane as organizations grapple with the challenges of the twenty-first century. Within the conundrum fueled by outside pressures and internal vulnerability of human coping mechanisms, employers will continue to encounter situations in the workplace which invoke emotional responses that may ignite into violence.

The successful employer will recognize the multi-faceted set of duties which require a balance of the rights of the employee with violent propensities and the rights of fellow employees and the consuming public. From contextual, careful leavening of the myriad of responsibilities, wise employers will construct solid and consistent defense mechanisms which erect protection for the workplace and provide fairness to employees.

AGAINST COOPERATIVE FEDERALISM

Michael S. Greve[*]

> Our citizens feel they have lost control of even the most basic decisions made about the essential services of government, such as schools, welfare, roads, and even garbage collection. They are right. A maze of interlocking jurisdictions and levels of government confronts the average citizen in trying to solve even the simplest of problems. They do not know where to turn for answers, who to hold accountable, who to praise, who to blame, who to vote for or against. The main reason for this is the overpowering growth of federal grants-in-aid programs during the past few decades.
>
> President Ronald W. Reagan,
> State of the Union Address, 1982.[1]

I. INTRODUCTION

The United States Constitution envisions political conflict and functional separation among independently constituted states and national institutions. Historically, this arrangement has been called "dual federalism,"[2] a term that emphasizes the co-existence of state governments with the federal government, with each level of government possessing its own sphere of

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[*] John G. Searle Scholar, American Enterprise Institute; Ph.D. (Government) Cornell University, 1987. I thank Jonathan Adler, Robert Gasaway and Curt Levey for helpful comments and Kim Kosman and Jinney Smith for their capable research assistance. All errors and misjudgments are mine.

[1] President Ronald W. Reagan, State of the Union Address (Jan. 26, 1982), http://www.cspan.org/executivestateoftheunion/sou82_trans.asp.

[2] Invention of the term is generally credited to Edward S. Corwin. *See* EDWARD S. CORWIN, THE TWILIGHT OF THE SUPREME COURT (1934); Edward S. Corwin, *The Passing of Dual Federalism*, 36 VA. L. REV. 1, 1 (1950) [hereinafter *Dual Federalism*].

autonomy and direct coercive authority over citizens. The "dual" adjective stresses federalism's vertical, state-to-federal dimension. In its horizontal, state-to-state perspective, the arrangement may also be called a "competitive federalism." Since dual federalism confines the national government to a limited sphere of autonomy, it compels the states, in the vast realm that lies beyond the national government's reach, to compete for citizens' assets, talents, and affections. Diversity among states, the citizens' ability to vote with their feet, and the disciplining force of state competition are federalism's chief attractions.[3]

In practice, however, American federalism has become an administrative, "cooperative federalism": state and local governments administer and implement federal programs.[4] Many state-administered programs are funded by the federal government, in whole or, more often, in part. Others take the form of conditional preemption, meaning that the states may choose to administer the federal program or else, cede the regulatory field to the federal government. Cooperative federalism covers an enormous array of regulatory fields, from the environment to education to welfare and, lately, crime control. In its horizontal dimension, cooperative federalism replaces dual federalism's competition with state policy cartels and uniform regulatory baselines.[5]

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[3] *See, e.g.*, THOMAS R. DYE, AMERICAN FEDERALISM: COMPETITION AMONG GOVERNMENTS (1990); THE NEW FEDERALISM: CAN THE STATES BE TRUSTED? (John Ferejohn & Barry R. Weingast eds. 1997); Jacques Leboeuf, *The Economics of Federalism and the Proper Scope of the Federal Commerce Power*, 31 SAN DIEGO L. REV. 555 (1994); Michael W. McConnell, *Federalism: Evaluating the Founders' Design*, 54 U. CHI. L. REV. 1484, 1493-1507 (1987) (book review).

[4] *See, e.g.*, Daniel J. Elazar, *Cooperative Federalism*, *in* COMPETITION AMONG STATES AND LOCAL GOVERNMENTS 65 (Daphne A. Kenyon & John Kincaid eds., 1991). The United States Supreme Court has used the term "cooperative federalism" both as denoting a form of conditional preemption, *see, e.g.*, Hodel v. Va. Surface Mining & Reclamation Ass'n, Inc., 452 U.S. 264, 289 (1980), and more broadly, as denoting the state enforcement of federal policies, *see, e.g.*, Prigg v. Pennsylvania, 41 U.S. 539, 631 (1842) (Taney, C.J., concurring). The Supreme Court has also employed the term "cooperative judicial federalism," meaning federal judicial deference to state court rulings. Bush v. Gore, 121 S. Ct. 525, 547-48 (2001) (Ginsburg, J., dissenting) (citing Lehman Bros. v. Schein, 416 U.S. 386, 391 (1974)). Unless indicated otherwise, I will use the term in the broad, general sense given in the text.

[5] One can imagine both a (vertically) dual federalism that is cooperative and

This article argues that cooperative federalism is a rotten idea, its political popularity notwithstanding. Cooperative federalism undermines political transparency and accountability, thereby heightening civic disaffection and cynicism; diminishes policy competition among the states; and erodes self-government and liberty. The sooner we can think of viable means to curtail cooperative programs and to disentangle government functions, the better off we shall be.

We may not be able to think of such means, much less to put them to work, any time soon. Dual, competitive (or, in modern public choice parlance, "market-preserving") federalism[6] is unstable, principally because it frustrates political and interest group demands. Under realistic conditions, dual federalism's legal-institutional structures will crumble and accommodate anti-competitive, cooperative entanglements.[7] The corollary proposition is that cooperative federalism, unlike

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cartelizing in its horizontal dimension (e.g., because the states themselves manage to form cartels), and a (vertically) cooperative federalism that is competitive in its horizontal dimension (e.g., because the central authority utilizes cooperative policies to enhance rather than suppress interstate competition). These possibilities, however, are merely theoretical. State cartels typically require central cooperation, for the same (free-rider) reasons that operate on private cartels. Albert Breton, *The Existence and Stability of Interjurisdictional Competition*, *in* COMPETITION AMONG GOVERNMENTS, *supra* note 4, at 49. Cooperative federalism will typically suppress competition because member-states, just like private competitors, will seek to mobilize the central government's authority so as to obtain monopolistic access to their customers (the citizens). Dual federalism will contain some (horizontally) cooperative arrangements, and cooperative federalism will allow some measure of horizontal competition. A handful of non-conforming policies, however, provide no reason to qualify the taxonomy employed here.

Uniformity is incomplete because cooperative federal programs typically allow the states to retain a measure of discretion in attaining the federal statutory objectives and, in many instances, the ability to regulate above (though of course not below) the federal baseline.

[6] Gabriella Montinola et al., *Federalism, Chinese Style: The Political Basis for Economic Success in China*, 48 WORLD POL. 50, 53 (1995); Barry R. Weingast, *Constitutions as Governance Structures: The Political Foundations of Secure Markets*, 149 J. INSTITUTIONAL & THEORETICAL ECON. 286, 289-90 (1993) [hereinafter *Political Foundations*]; Barry R. Weingast, *The Economic Role of Political Institutions: Market-Preserving Federalism and Economic Development*, 11 J.L. ECON. & ORG. 1, 3 (1995) [hereinafter *Political Institutions*].

[7] *See generally* Jonathan Rodden & Susan Rose-Ackerman, *Does Federalism Preserve Markets?*, 83 VA. L. REV. 1521 (1997).

its virtuous but frail competitive cousin, *is* stable. It accommodates the political and interest group demands that dual federalism frustrates, thus giving organized groups a stake in the system. "Stable" does not mean static: cooperative federalism periodically accommodates new demands, at a higher level of aggregate government spending. The moving political equilibrium point is the next circle of hellish entanglement.[8] "Stable" simply means that fundamental institutional challenges, and especially attempts to re-introduce competitive structures, will usually founder on cooperative federalism's political economy.

We have nothing resembling a political theory that would explain how dual, market-preserving federalism might preserve itself,[9] or how it might re-emerge from a cesspool of cooperation. The difficulty of the task may help explain why thoughtful scholars have acknowledged and conceded potent arguments against cooperative arrangements, and then dismissed those arguments on the grounds that cooperative federalism is real and therefore rational, or at any rate inevitable.[10] Before we succumb to Hegelian insouciance, though, cooperative federalism's manifest failures and dysfunctionalities compel another look at the problem of moving from cooperation to competition.

In an earlier attempt to tackle the problem, I identified a scenario that might, under present political conditions, allow a

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[8] *See, e.g.*, George F. Break, *Intergovernmental Fiscal Relations*, *in* SETTING NATIONAL PRIORITIES: AGENDA FOR THE 1980S 250 (Joseph A. Pechman ed., 1980) (noting that new forms of intergovernmental assistance are piled on top of old ones, rather than replacing them).

[9] Rodden & Rose-Ackerman, *supra* note 7, at 1571-72.

[10] *See, e.g.*, Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and 'Dual Sovereignty' Doesn't*, 96 MICH. L. REV. 813, 828, 831-32 (1998) (conceding that "erosion of accountability is endemic to all forms of cooperative federalism" but insisting that constitutional theory that would bar cooperative arrangements "is entirely unacceptable in the late twentieth century, when systems of cooperative federalism are commonplace"); *see also* Rodden & Rose-Ackerman, *supra* note 7, at 1554 (process of political centralization and entanglement "does not appear to be reversible"). In fairness, Rodden and Rose-Ackerman are much less prone than Hills to confuse cooperative federalism's political resilience with its desirability. *See id.* at 1559 ("[Cooperative federalism] has evolved more as a self-interested political strategy than a conscious attempt to increase efficiency or fairness in intergovernmental relations.").

piecemeal restoration of a dual, competitive, "real" federalism.[11] That scenario revolved around the interplay between a gradual judicial return to a robust enumerated-powers doctrine and the mobilization of anti-distributional "Leave-Us-Alone" constituencies with a stake in more competitive politics. A scenario, of course, is neither a certainty nor a theory. As this article will make clear, I am inclined to think that the odds are actually against an escape from cooperation, and I am no closer now than two years ago to a theory of restoring competitive federalism. On the other hand, a plausible scenario that responds to the right theoretical question may warrant additional, marginal efforts-at least until more promising, rigorous theories emerge or else, the project is shown to be futile.

In that spirit, this article provides a footnoted harangue, known among lawyers as a "brief," against cooperative federalism. If competitive federalism can be restored, a critique of the cooperative status quo will prove helpful. If it can not, we shall never know what we are missing.[12] But we should still lament, rather than celebrate, our cooperative fate.

Cooperative federalism in America is not an extension of the constitutional scheme and its institutional logic. It is rather a set of infra-constitutional institutional arrangements and policy regimes that are constrained, albeit weakly, by constitutional norms, such as the implied Tenth Amendment prohibition against the federal "commandeering" of state and local officials.[13] Many other countries, however, have adopted coop-

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[11] *See generally* MICHAEL S. GREVE, REAL FEDERALISM: WHY IT MATTERS, HOW IT COULD HAPPEN (1999).

[12] Lest this sound hyperbolic, consider an example: in 1978, the United States Supreme Court determined that interstate credit card transactions are governed by the usury and consumer protection laws of the credit institute's place of business, rather than the customer's residence. Marquette Nat'l Bank v. First of Omaha Serv. Corp., 439 U.S. 299, 308 (1978). The ruling prompted banks to locate in friendly jurisdictions and, in due course, triggered a rapidly growing and increasingly efficient credit market. Christopher C. DeMuth, *The Case Against Credit Card Interest Rate Regulation*, 3 YALE J. ON REG. 201, 241-42 (1986). Assume the opposite, anti-competitive holding: all of us would be carrying credit cards from local gas stations and supermarkets without imagining, let alone lobbying for, a more competitive world.

[13] Printz v. United States, 521 U.S. 898, 919-21 (1997); New York v. United States, 505 U.S. 144, 174-75 (1992).

erative federalism as a constitutional arrangement. Among those countries is Germany, and it is there that I will begin my brief against cooperative federalism (Section II). I take this excursion at the invitation of Justice Breyer, whose dissenting opinion in *Printz v. United States* commends European federalism practices as a plausible model for the United States.[14] While "[t]he fact is that our federalism is not Europe's,"[15] a visit abroad serves to show that cooperative federalism's pathologies are endemic, rather than an accidental by-product of American institutional practices. In Germany, those pathologies have become so severe that the country, though traditionally proud of its cooperative federalism, is now conducting a vigorous debate about its defects. Not much will come of that debate, since cooperative federalism's entanglements suffocate desperately needed reforms. Both the debate and its disheartening prospects, though, contain sobering lessons for America and its experiment with cooperative federalism.

Returning to the more familiar American ground, Section III provides a brief history of cooperative federalism. Section IV shows that cooperative federalism cannot be justified as an effective or public-interested regime. Rather, it can only be understood as an accommodation to interest group demands and to the interests of imperfectly monitored political actors, state and federal (Section V). Irremediable agency problems produce intra-governmental collusion against citizens. Political remedies for cooperative federalism and its pathologies are possible only under exceptional circumstances. Barring such circumstances, cooperative pathologies can only be curbed by means of constitutional, judicially enforced constraints. Section

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[14] *Printz*, 521 U.S. at 976-77 (Breyer, J., dissenting).

> The federal systems of Switzerland, Germany, and the European Union . . . all provide that constituent states, not federal bureaucracies, will themselves implement many of the laws, rules, regulations, or decrees enacted by the central "federal" body. They do so in part because they believe that such a system interferes less, not more, with the independent authority of the "state," member nation, or other subsidiary government, and helps to safeguard individual liberty as well.

Id. (Breyer, J., dissenting) (citation omitted).

[15] *Printz*, 521 U.S. at 921 n.11. The quoted sentence constitutes Justice Scalia's response to Justice Breyer's European comparison. *Id.*

VI explores the political and the constitutional reform options and-fully showing a hopelessly tipped hand-makes a tentative normative case for judicial constraints on cooperative federalism.

II. COOPERATIVE FEDERALISM: THE GERMAN EXPERIENCE[16]

Contemporary Germany is not a happy country. Its political leaders and opinion elites lament the country's lagging economic performance, as measured by anemic growth rates and sustained high unemployment.[17] Despite a general consensus that the source of Germany's economic malaise lies in punitive taxes and in labor and welfare laws that have made German labor the most expensive in the world, those regimes seem immune to reform. The high of reunification was followed by recriminations and regrets over the exorbitant costs. The Germans worry greatly over civic disaffection (Politikverdrossenheit), which finds expression in voter disengagement and, more troubling, in growing support for radical parties, left and right. Germany's grumpiness is nothing new, good cheer never having been a hallmark of her politics. What is new and noteworthy is that academics, opinion leaders, and politicians have come to tag cooperative federalism as the source of Germany's problems.

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[16] A version of this section has previously appeared as Issue #3 (Sept. 2000) of the Federalist Outlook, a newsletter published by the American Enterprise Institute's Federalism Project. *See generally* Michael S. Greve, *Cooperation Does Not Work*, AEI FEDERALIST OUTLOOK (American Institute for Public Policy Research, Washington, D.C.), Sept. 2000, *available at* http://www.federalismproject.org/outlook/9-2000.html.

[17] Between 1992 and 1999, German GDP growth averaged 1.4, far lagging the averages for the OECD (2.6), the United States (3.6), and even the European Union (1.9). *See* OECD ECONOMIC OUTLOOK 211 (Annex Table 1) (Dec. 2000). Post-unification Germany's unemployment rate has consistently exceeded 8 percent, somewhat below the EU average but far above the United States average, which declined from 7.5 (1992) to 4.2 (1999). *Id.* at 232 (Annex Table 22).

A. The Constitutional Framework

Germany's federalism, unlike ours, is cooperative by constitutional design. Under the German Constitution, originally enacted in 1949 as the "Basic Law" of the Federal Republic of Germany, the federal government administers a few institutions, such as the foreign service, the armed forces, and the Bundesbank.[18] On the other hand, schools and the local police are left to state and local governments. The general constitutional rule, however, is that the Laender-that is, the states—administer federal statutes and regulations "as their own affair" [als eigene Angelegenheit][19] or, in a few cases, on behalf of the federal government [im Auftrag des Bundes].[20] The Laender participate as political entities in the formation of federal policy: federal statutes that substantially affect the states (especially their budgets and administrative obligations) require the assent of the Bundesrat, an assembly of the states' delegations.[21] But the states' "independent authority" lies, as Justice Breyer's *Printz* dissent correctly observes, in their administrative autonomy.[22] The Laender enjoy certain protections against direct federal interference in the administrative process;[23] on the other hand, they must administer federal programs on their own nickel.[24]

Independent administration, if taken seriously, poses a risk that the country might disintegrate into a confederation. To prevent that outcome, the Basic Law matches independent

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[18] Grundgesetz [GG] [Constitution] arts. 87(1), 87b(1), 88 (F.R.G.) (relating to, respectively, foreign service and other institutions, armed forces and the Bundesbank).

[19] Grundgesetz [GG] art. 83 (F.R.G.).

[20] Grundgesetz [GG] art. 85 (F.R.G.).

[21] The types of federal laws requiring the Bundesrat's assent are listed in scattered sections of the Basic Law. Grundgesetz [GG] arts. 85(1), 91(a), 105(3), 108(2) (F.R.G.). The most common trigger is the conferral of administrative obligations under federal law. *See* Grundgesetz [GG] art. 84 (F.R.G.).

[22] *See supra* note 14.

[23] Grundgestetz [GG] arts. 84, 85 (F.R.G.).

[24] Grundgestetz [GG] art. 104a(2), (5) (F.R.G.). For example, the federal government will pay the direct costs of child support payments but not the cost of administering them. *Id.*

state administration with a fiscal mechanism to ensure that the Laender will toe the federal line. The operational core of German federalism is the Financial Constitution (Finanzverfassung). It is contained Articles 104-109 of the Basic Law, encompassing 33 long, often amended and, to all but a few experts, impenetrable paragraphs. The constitutional principle is general revenue sharing; personal and corporate income taxes as well as value-added taxes raised in the states—all told, some 75% of the total tax take of government at all levels[25]—are shared between the federal government, the Laender, and local governments.[26] The vertical distribution between the states and the federal government must be "equitable," avoid excessive burdens on taxpayers (good luck), and preserve the "uniformity of living conditions" (Einheitlichkeit der Lebensverhaeltnisse) within the nation.[27] The states' share is subject to a constitutional scheme of horizontal financial compensation; revenue-rich states must support poorer states.[28] In addition, the federal government may use its own funds to supplement the poorer states' budgets.[29]

The Financial Constitution bears enormous institutional weight. The vertical division of funds between the federal and the subordinate governments must be calibrated to prevent one

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[25] Arthur B. Gunlicks, *German Federalism After Unification: The Legal/Constitutional Response*, 24 PUBLIUS 81, 85 (1994).

[26] Grundgesetz [GG] art. 106(3) (F.R.G.).

[27] Grundgesetz [GG] art. 106(3)2. The "uniformity of living conditions" clause neatly marks the difference between a cooperative, administrative federalism and a dual, competitive federalism, which owes its attractiveness to the fact that living conditions are not uniform across the states. Curiously, the formula appears in the constitutional provision that governs the vertical financial distribution, but not in Grundgesetz [GG] art. 107(2) (F.R.G.)., which governs the horizontal financial compensation among states. *See infra* note 30 and accompanying text. The "uniformity" clause used to appear also in Grundgesetz [GG] art. 72(2) (F.R.G.), as an objective of the federal government's general (concurrent) legislative authority. After reunification, Grundgesetz [GG] art. 72(2) was amended to require "equivalent" (gleichwertig) instead of "uniform" living conditions, most likely because an unusually keen drafter realized that living conditions between East and West might not become uniform for quite some time. "Uniformity" survived, however, in GG art. 106(3)2. The textual inconsistency is in practice inconsequential and, in any event, among the least of the Financial Constitution's problems.

[28] Grundgesetz [GG] art. 107(2).

[29] *Id.*

from becoming parasitic on the other(s).[30] Horizontal compensation must be sufficient to produce consensus and solidarity among the Laender, and yet not so extensive as to prompt the donor states' resentment. These conflicting and cross-cutting demands have rendered the Financial "Constitution" and its implementing legislation a permanent work in progress—the subject of ceaseless legislative revision, constitutional amendment, and litigation. Germany's Constitutional Court has issued four comprehensive rulings on the matter. In its most recent decision of November 1999, the Court found that the existing revenue-sharing laws and regulations bear no rational relation to the constitutional requirements.[31] Reluctant to void an arrangement that is, after all, central to the operation of German federalism, the Court gave the politicians two years to fix the system. Like segregation in America, anno 1954, Germany's financial compensation system is unconstitutional in principle—but not just yet.

B. Cooperative Federalism's Discontents

The essence of cooperative federalism, as just seen, is intra-governmental conflict, both vertical and horizontal, over a pot of money. And yet, for well over three decades, German federalism generally produced an outward appearance of the consensus for which German politics is famous. That consensus, or the appearance thereof, was produced through periodic tax increases. Hold revenues constant, and the distributional conflicts will soon become unmanageable. A growing revenue pie, in contrast, makes it possible to produce periodic intergovernmental equilibrium points by growing government at all

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[30] The continuously revised and amended Financial Constitution is the latest chapter in modern Germany's unending effort to find a satisfactory arrangement between the Laender and the national government. Each successive arrangement was criticized as rendering one overly dependent on the other. (A famous phrase of the "Reich als Kostgaenger der Laender," meaning the states' parasite, was coined by Bismarck). For a thorough historical account, see generally Juergen W. Hidien, DER BUNDESSTAATLICHE FINANZAUSGLEICH IN DEUTSCHLAND: GESCHICHTLICHE UND STAATSRECHTLICHE GRUNDLAGEN (1999).

[31] The Court's decision and opinion, 2-BvF-2/98 (Nov. 11, 1999), *available at* http://www.bverfg.de.

levels.[32] Cooperative federalism, in short, requires government growth.

At the same time, cooperative federalism facilitates government growth. Intra-governmental cooperation means shared political responsibility, which in turn means that citizens cannot easily finger the culprits for government bloat and trainwrecks, much less hold them to account. It may be that democratic governments of all stripes—unitary or federalist, competitive or cooperative—tend towards expansion. But if one had to invent an institution that will reliably maximize the size of government, cooperative federalism would be a splendid choice.

As the intra-governmental conspiracy moves onward and upward, expanding political commitments produce further interdependencies and conflict. The ineluctable tendency is towards a pathology that German scholars and high-brow journalists call Politikverflechtung, meaning a political meshing or entanglement.[33] Political scientists and legal scholars have shown that cooperative federalism produces, first, a loss of transparency and, consequently, rising civic discontent. As government grows and the range of cooperative arrangements expands, transparency, accountability, and responsibility diminish exponentially. Second, cooperative federalism stifles political competition and, consequently, political innovation and economic growth. Germany's Financial Constitution, and in particular the commands to harmonize living conditions and to equalize financial resources across the various states, diminishes every state's incentive to improve its lot by providing a favorable economic climate. It systematically punishes wealthy, successful states, while rewarding the basket cases.[34] Finally,

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[32] AARON WILDAVSKY, *Fruitcake Federalism or Birthday Cake Federalism*, *in* FEDERALISM & POLITICAL CULTURE 55, 60-62 (David Schleicher & Brandon Swedlow eds., 1998).

[33] The term was coined some time ago by Fritz W. Scharpf, Germany's preeminent federalism scholar. *See* Fritz W. Scharpf, *Theorie der Politikverflechtung*, *in* POLITIKVERFLECHTUNG: THEORIE UND EMPIRIE DES KOOPERATIVEN FOEDERALISMUS IN DER BUNDESREPUBLIK 13 (Fritz W. Scharpf, et al., eds., 1976).

[34] *See, e.g.*, Martin T.W. Rosenfeld, *The Present Problems and the Future of Cooperative Federalism in Germany*, 49 BEIHEFT DER KONJUNKTURPOLITIK (1999), English abstract *available at* http://www.diw.de/deutsch/publikationen/Konjunkturpolitik/beihefte99/ (visited Aug. 31, 2000). In the litigation over the

cooperative federalism produces political paralysis. Instead of enhancing the states' autonomy, it rewards the most intransigent participant. In the end, every player becomes a hold-out, and reform becomes impossible. Scholars, journalists, and leading politicians have tagged cooperative-federalist arrangements as a principal cause of Germany's Reformstau (reform jam, as in "traffic jam")—that is, Germany's inability to adjust its institutions and policies to the demands of a modern, global economy.[35]

C. The Current Debate

In recent years, cooperative federalism's pathologies have induced academic experts to call for institutional and constitutional reforms that would produce a more competitive federalism.[36] The insight that cooperative arrangements are in urgent need of reform does not come easily to a country accustomed to consensus. Events and developments of the past decade, however, have made the need for more competitive institutions inescapable.

One of those events is the process of economic globalization and, within that context, European integration, which have made it increasingly difficult to hide the dysfunctionalities of domestic cooperative arrangements. Luxembourg and the Saarland are two adjacent, bathmat-sized jurisdictions in the

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Financial Constitution, donor states argued vociferously, albeit unsuccessfully, that excessive financial transfers distort the incentives of poor and rich states alike. *See* 2-BvF-2/98 (Nov. 11, 1999), at 216-17 (summarizing states' argument), *available at* http://www.bverfg.de.

[35] *See, e.g.*, Rosenfeld, *supra* note 34. In the litigation over the Financial Constitution, donor states argued vociferously, albeit unsuccessfully, that excessive financial transfers distort the incentives of poor and rich states alike. *See* 2-BvF-2/98 (Nov. 11, 1999), at 216-217 (summarizing states' argument), *available at* http://www.bverfg.de.

[36] *See, e.g.*, THOMAS APOLTE, DIE OEKONOMISCHE KONSTITUTION EINES FOEDERALEN SYSTEMS: DEZENTRALE WIRTSCHAFTSPOLITIK ZWISCHEN KOOPERATION UND INSTITUTIONELLEM WETTBEWERB (1999); ADRIAN OTTNAD & EDITH LINNARTZ, FOEDERALER WETTBEWERB STATT VERTEILUNGSSTREIT. VORSCHLAEGE ZUR NEUGLIEDERUNG DER BUNDESLAENDER UND ZUR REFORM DES FINANZAUSGLEICHS (1997); Karl-Heinrich Hansmeyer, *Federalism in Europe-Problems and Questions for Research*, 49 BEIHEFT DER KONJUNKTURPOLITIK (1999), English abstract *available at* http://www.diw.de/deutsch/publikationen/Konjunkturpolitik/beihefte99/.

heart of Western Europe, both once heavily dependent on the region's steel and coal production. Luxembourg has turned itself into Europe's Delaware—a prosperous haven for banks and investors, who are attracted by the country's favorable regulatory and tax policies. The Saarland, in contrast, has become an impoverished backwater, whose main export is its citizens. Some 25,000 commuters work in the Saarland but live in neighboring France to escape Germany's confiscatory taxes.[37] Tax flight into France is a sure sign of trouble at home. It has dawned on the politicians that the Saarland's travails, and Luxembourg's good fortune, have to do with the fact that Luxembourg has had the energy and the freedom to compete, whereas the Saarland is locked into Germany's federalism cartel.[38]

The immediate, natural impulse is to export cooperative arrangements and their regulatory desiderata. That tendency is reflected, for instance, in Germany's initiatives, in the European Community and beyond, to crack down on international "tax havens" and to impose expansive regulatory commitments on the Community's member-states.[39] Such advances, however, encounter predictable resistance from more competitive (or, as the case may be, less developed) countries. The European Community's unanimity requirements further inhibit attempts to push cooperative dysfunctionalities upstream. Germany's international advances have been insufficiently successful to obviate the need for domestic institutional reform.

At the same time, German reunification put the country's political institutions, and especially a Financial Constitution designed for a cartel of approximate equals, under enormous strain. Political competition would have provided an attractive solution; had the new Laender remained exempt from West Germany's labor and welfare laws, capital and jobs would have

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[37] Thomas Christmann, *Vom Finanzausgleich zum Massstaebegesetz*, 53 DIE OEFFENTLICHE VERWALTUNG Vol. 315, 321 (No. 8, Apr. 2000).

[38] *Id.* at 317.

[39] *See, e.g.*, *unds Come out Fighting as Bank Tracks the Trackers*, THE GUARDIAN, Apr. 17, 1999, at 25 (describing Germany's attempts to implement European tax-on-savings law and statutory code to control takeovers and mergers).

moved east, thus offering the hope of a reasonably prompt economic integration. Instead, Chancellor Kohl's Christian-Democratic government inflicted those entitlements—unsustainable even in productive West Germany—on the East and showered that economic wasteland with subsidies. Over 80 percent of revenue-sharing proceeds wind up in the old East.[40] In addition, the government legislated an income tax surcharge to pay for East Germany's reconstruction. (The surtax is not called a tax but a "solidarity contribution" so as to remove it from the constitutional revenue-sharing arrangements. Otherwise, even poor states in the old West would have turned into net payers.)[41] Jobs and capital still went east, all the way to Poland and the Czech Republic.[42]

In July 2000, to the acclaim of the international financial markets, the coalition government of Social Democrats and Greens did manage to enact a corporate tax reform that will modestly reduce tax rates and allow tax-free sales of corporate stock holdings, thus facilitating their transfer from German banks into the hands of investors who have a higher and better use for the assets.[43] As if to illustrate the pathology of cooperative federalism, however, the tax reform was accomplished through a dramatic break with its operating principles. Anticipating opposition from a majority of Laender in the Bundesrat, Chancellor Gerhard Schroeder took the unprecedented step of purchasing the votes of three fence-sitting Laender delegations by promising them several hundred million marks in federal assistance outside the bounds, and arguably in derogation, of the Financial Constitution.[44]

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[40] PETER SCHADE, GRUNDGESETZ MIT KOMMENTAR 224 (5th ed. 2000).

[41] Gunlicks, *supra* note 25, at 85-88.

[42] German net investments in the Czech Republic surged from $82 million (1993) to $538 million (1998) and, in Poland, from $223 million (1993) to $1,366 million (1998). Germany is the second largest investor in both countries, accounting for over 20 percent of foreign net capital investment. INTERNATIONAL DIRECT INVESTMENT STATISTICS YEARBOOK 89, 276 (1999 ed. & OECD 2000).

[43] *See, e.g.*, Wolfgang Munchau, *Germany Takes Small Step in Right Direction: Tax Reform is a Political Triumph for Gerhard Schroeder but Will Only Go Part of the Way to Curing the Country's Economic Ills*, FINANCIAL TIMES (London), July 17, 2000, at 13.

[44] The Constitutional Court's November 1999 decision and opinion on the Fi-

Many Germans, including the Christian Democratic opposition, complained bitterly about Mr. Schroeder's extra-constitutional tax escapade. Others cheered the long-overdue reform and its proximate cause—a Chancellor with the authoritarian streak of Third Way politicians across the globe. There is broad consensus, however, that occasional policy improvisation is no substitute for institutional reforms that would produce a more open, competitive federalism. Proposals to this effect have been taken up by one political party (the Free Democrats) and by a handful of state governments.[45] In the latest round of litigation over the Financial Constitution, the plaintiff-states urged the Constitutional Court to pay heed to the perverse incentive effects of a compensation-oriented revenue-sharing arrangement. Beyond the legal controversy over the Financial Constitution, Germany's politicians, academics, and opinion leaders are conducting a serious discussion about cooperative federalism, its ill effects, and the need for political competition. "Competitive federalism" has found its way into the political lexicon and into public debate.[46]

The debate, though, comes alarmingly late in the day, long after shocks and dislocations (especially reunification) that should by all rights have led to fundamental reforms.[47] More-

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nancial Constitution explicitly anticipated, and declared constitutionally unacceptable, political attempts to use federal "supplementary remissions" (Ergaenzungszuweisungen) pursuant to Grundgesetz [GG] [Constitution] art. 107(2) as a means of circumventing a constitutional and equitable system of horizontal and vertical compensation. 2 BvF-2/98 (Nov. 11, 1999), at 329-37, *available at* http://www.bverfg.de. Mr. Schroeder's transaction arguably violates these strictures.

[45] For the Free Democratic Party, see WIDER DIE ERSTARRUNG IN UNSEREM STAAT-FUER DIE ERNEUERUNG DES FOEDERALISMUS (Friedrich Naumann Stiftung, ed., 1998). For state governments, see Christmann, *supra* note 37, at 315.

[46] "Competitive" (or "kompetitiv") is not actually a German word. But since it has no equivalent measuring under three inches in print, the Germans have adopted the Anglicism. *See, e.g.*, Horst Siebert, *Mehr Standortwettbewerb beim Finanzausgleich-Ein kompetitiver Foederalismus gehoert zur Modernisierung Deutschlands*, FRANKFURTER ALLGEMEINE ZEITUNG, Aug. 8, 2000, at 17.

[47] *See generally* Charlie Jeffery, *The Non-Reform of the German Federal System After Unification*, 18 W. EUR. POL. 252 (1995); Wolfgang Renzsch, *Die Verfassungsreform blieb aus*, 44 DAS PARLAMENT 14 (Jan. 14, 1994) (failure to amend federalist structures after unification reflects fundamental inability to reform system).

over, Germany's cooperative federalism rests on very old and stubborn political traditions. The constitutional dimension of the federalism debate ensures that it will be dominated by legal scholars, most of whom believe that competition has no place in law and government. (Unlike private actors, their hoary theory goes, government will automatically act in the public interest.)[48] The revision of the revenue-sharing system, necessitated by the Constitutional Court's November 1999 ruling on the Financial Constitution, provides the best and most urgent opportunity for pro-competitive reforms. Unfortunately, however, the Court ignored the plaintiff-states' arguments concerning the anti-competitive effects of the existing regime.[49] Instead, the Court instructed the federal legislature to design a new, fair and rational compensation scheme behind, so far as possible, a Rawlsian "veil of ignorance"—that is, without regard to the immediate fiscal effects or the various governments' actual political interests.[50] The odds that the politicians will produce, from the shelter of an original position, a law that meets the criteria of practical reason and, moreover, binds all future politicians, are exceedingly slim.[51]

Most fatefully, the competitive reform impulse is likely to disappear in what scholars have called the "trap of cooperative federalism."[52] Federalism reform, the *Frankfurter Allgemeine Zeitung* has editorialized, isn't hard to figure out: segregate

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[48] Christmann, *supra* note 37, at 321 (rejecting argument that competitive structures would create appropriate incentives for state governments because state actors are "constitutionally bound to laws and the public good and need not be stimulated to act in the public interest.").

[49] *Id.* at 315; *see also* Hans Peter Bull & Veith Mehde, *Der rationale Finanzausgleich-ein Gesetzgebungsauftrag ohnegleichen*, 53 DIE OEFFENTLICHE VERWALTUNG 305, 306-07 (No. 8, Apr. 2000).

[50] *See* the Court's opinion, 2-BvF-2/98 (Nov. 11, 1999), at 282, (citing JOHN RAWLS, A THEORY OF JUSTICE), *available at* http://www.bverfg.de. The Court's call for a quasi-constitutional revenue-sharing superlaw is endorsed, with reservations, by Bull & Mehde, *supra* note 49, at 306. It is rejected, on constitutional grounds, by Joachim Linck, *Das 'Massstaebegesetz' zur Finanzverfassung-ein dogmatischer und politischer Irrweg*, 53 DIE OEFFENTLICHE VERWALTUNG 325 (No. 8, Apr. 2000).

[51] Bull & Mehde, *supra* note 49, at 309; Christmann, *supra* note 37, at 324; Linck, *supra* note 50, at 326.

[52] *See, e.g.*, Rosenfeld, *supra* note 35; and generally sources cited *supra* note 36.

revenue sources between states, localities, and the federal government; segregate the governments' tasks and functions; put competition in play.[53] However, a tangled, cooperative government apparatus is probably incapable of acting on this insight. The institutional structures and dynamics that make competitive reform imperative also render it impossible. That is a lesson which American friends of cooperative federalism would do well to consider.

III. COOPERATIVE FEDERALISM, AMERICAN STYLE

Germany's constitutional cooperative federalism is, in a precise sense, un-American. Its embrace of governmental interdependence is rooted in the intellectual and political traditions of the European federations that the Federalist Papers depict as a warning example, in gruesome and "melancholy" detail.[54] Intergovernmental cooperation, too, was the operating principle of the Articles of Confederation, which (to put it mildly) did little to inspire the Founders' confidence. A "government over governments," the Founders warned, would be dependent upon the member-states, and hence tend toward "imbecility."[55] It would either disintegrate or else be compelled to maintain a large standing army to suppress domineering tendencies with brute force.[56] Hence, the Founders separated and segregated the national and state governments—with respect to their constitution, their functions, their tax authority and their enforcement capacity—and enabled the national government to legislate directly upon the citizens, rather than intermediate gov-

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[53] *Kopf hoch, Fuersten!*, FRANKFURTER ALLGEMEINE ZEITUNG Aug. 12, 2000, at 11 (editorial). For scholarly proposals along these lines see Thomas Lenk & Friedrich Schneider, *Zurueck zum Trennsystem als Koenigsweg zu mehr Foederalismus in Zeiten des 'Aufbau Ost'?*, 219(3-4) JAHRBUECHER FUER NATIONALOEKONOMIE UND STATISTIK 409 (1999); and Ottnad & Linnartz, *supra* note 36.

[54] THE FEDERALIST NO. 20, at 137 (James Madison & Alexander Hamilton) (Clinton Rossiter ed., 1961).

[55] *Id.* at 138, 135.

[56] See, in this context, Madison's discussion of the Grecian confederacy in THE FEDERALIST NO. 18, at 122-25 (James Madison & Alexander Hamilton) (Clinton Rossiter ed., 1961).

ernments. The logic of the written Constitution is the opposite of intergovernmental cooperation-independent national authority, coupled with institutional competition, rivalry, and jealousy.[57]

In practice, however, we have adopted a great deal of cooperative federalism, albeit in the same way in which we typically import European policies and ideas—without a clear sense of their implications and ideological dimensions, in fits and starts, in this policy arena and that, and without seriously aspiring to, never mind achieving, the kind of policy coherence and ambitious public purposes the Europeans commonly associate with their politics. We have no Financial Constitution and no systematic attempt, comparable to Germany's, to agree on the criteria and parameters of an equitable distribution of federal funds to state and local governments. What we have instead is a permanent wrangle over a pot of money.[58] Similarly, we often commit the enforcement of intragovernmental arrangements—for instance, of regulatory requirements that are attached to federal funds—to private litigants. The thought that bargains among sovereign entities, and the national purpose they embody, should be officially entrusted to private advocacy groups has not occurred to the Germans[59]—perhaps, because

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[57] In this sense, Roderick M. Hills is right in insisting that the Founding Generation's hostility to cooperative federalism was tied to nationalist commitments. *See supra* note 10, at 832-39.

[58] *See, e.g.*, THE FEDERAL ROLE IN THE FEDERAL SYSTEM: THE DYNAMICS OF GROWTH 49 (Advisory Commission of Intergovernmental Relations, 1981) ("inattention to the problem of fiscal equalization is a distinctive feature of the American intergovernmental aid system"); *id.* at 39 ("few analysts believe that the federal grant-in-aid system has ever reflected a clear conception of appropriate national objectives or national purposes"); Herman B. Leonard & Jay H. Walder, *Executive Summary*, *in* THE FEDERAL BUDGET AND THE STATES: FISCAL YEAR 1999 (Harvard Univ. Taubman Center for State and Local Government & John F. Kennedy School of Government, 24th ed. 2000), at 1 ("[Federal] financial flows to and from each of the staters have rarely been examined outside the context of individual programmatic issues.")

[59] The modern American phenomenon of private litigants acting in a capacity of "private attorneys general" is unknown in German law. *See* SUSAN ROSE-ACKERMANN, CONTROLLING ENVIRONMENTAL POLICY: THE LIMITS OF PUBLIC LAW IN GERMANY AND THE UNITED STATES (1995); Michael S. Greve, *The Non-Reformation of German Administrative Law: Standing to Sue and Public Interest Litigation in West German Environmental Law*, 22 CORNELL INT'L L.J. 197, 197-208

they lack our sense of humor, but more likely, because they can still tell the difference, increasingly elusive in American politics, between a public purpose and an interest group racket.

Despite its lack of a constitutional pedigree and its haphazard character, however, American cooperative federalism has proven extremely resilient. Infra-constitutional cooperative arrangements, moreover, have produced pathologies that parallel Germany's experience: a weakening of political accountability and transparency; a sprawling, bloated, poorly administered government; political paralysis and civic disengagement.

These pathologies, obviously, differ from the Founders' fears of continuous strife and eventual disintegration. The Constitution itself solved those problems. The national government commands revenue sources that are independent of the states (including, since 1913, citizens' income), and can therefore afford to share the proceeds with the states without becoming dependent upon them. The national government also possesses the authority to enforce its own laws; thus, its decision to share that authority with the states is rather like a (revocable) contract, and a grant-in-aid or a conditional funding program closely resembles a fee for services rendered by the states.[60] Such cooperative arrangements create numerous problems, but constitutional dissolution is not among them.

Nonetheless, cooperative federalism and its pathologies have a constitutional dimension. Cooperative arrangements between the states and the federal government feature massive agency and monitoring problems on both sides of the bargain. Dual, competitive federalism seeks to minimize those dangers by confining the states and the national government to distinct spheres: by giving ambitious, turf-conscious institutional actors incentives to resist and to rat on each other; and by allowing citizens, in the domain beyond the national government's reach, to vote with their feet, thus adding the disciplining force of exit to the often ineffectual option of voice.[61] Cooperative federal-

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(1989).

[60] Hills, *supra* note 10, at 861.

[61] *See generally* ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY (1970); Richard A. Epstein, *Exit Rights Under Federalism*, 55 LAW & CONTEMP. PROBS.

ism, in contrast, exploits the slack between citizens and the governmental agents on each end of the bargain, and then utilizes each bargain to drive citizens' monitoring and enforcement costs through the roof.

A passing familiarity with the Federalist Papers shows that the Founders sought to foster institutional conflicts as "auxiliary precautions" against the dangers of an overbearing government.[62] Institutional collusion eviscerates those precautions and, at some point, runs up against central constitutional values. While cooperative federalism may not be unconstitutional in all or even most of its forms and applications, the manifest threat to constitutionalism, coupled with systemic impediments to political reform, make a powerful case for more stringent, judicially enforceable checks on intragovernmental cooperation.

That is where the argument leads. It begins in this section with a very brief history of cooperative federalism. For the purposes at hand, that history can be arranged in three periods: origin and growth; a brief challenge in the early 1980s; and renewed growth thereafter.

A. Origin and Growth

Notwithstanding a famous (but unpersuasive) argument that American federalism was cooperative *ab ovo*, and notwithstanding a handful of "cooperative" policies in the 19th century (such as land grants), cooperative federalism was largely an invention of the Progressives, who attempted to reconcile their nationalist ambitions with their affection for local government.[63] After the enactment of the Sixteenth Amendment in

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147 (1992).

[62] THE FEDERALIST NO. 51, at 322 (James Madison) (Clinton Rossiter ed., 1961).

[63] The source of the influential argument concerning the cooperative dimension of early American federalism is Daniel J. Elazar, *The American Partnership* (1962). For a critique, see Harry Scheiber, *American Federalism and the Diffusion of Power: Historical and Contemporary Perspectives*, 9 U. TOL. L. REV. 619, 633-34 (1978). The Progressive roots of cooperative federalism are stressed in Martha Derthick, *How Many Communities? The Evolution of American Federalism*, *in* DILEMMAS OF SCALE IN AMERICA'S FEDERAL DEMOCRACY 125 (Martha Derthick, ed., 1999). Derthick's essay is a brief but characteristically lucid and balanced ac-

1913, federal income tax proceeds provided the national government with the revenues to induce state and local cooperation in the implementation of federal policies, such as highway construction in the 1920s.

Cooperative federalism came into its own with the New Deal and the creation of social security and other public assistance programs. The spirit of the age is captured in a "Declaration of Interdependence," signed by state and local government representatives in 1937:

> When, in the course of human events, it becomes necessary for a nation to repair the fabric which unites its many agencies of government, and to restore the solidarity which is vital to orderly growth, it is the duty of responsible officials to define the need and to find a way to meet it. . . .
>
> Through established agencies of cooperation, through uniform and reciprocal laws and regulations, through compacts under the Constitution, through informal collaboration, and through all other means possible, our nation, our states, and our localities must fuse their activities with a new fervor of national unity.[64]

The "orderly growth" that must be pursued "through all other means possible"—what, after all, is a Constitution among friends?—is the growth of government.[65] Thirteen years later, Edward S. Corwin would identify the New Deal and its "enlarged theories of the function of government" as the principal cause of the shift from dual to cooperative federalism.[66]

Cooperative policies and arrangements mushroomed in the 1960s and 1970s with the creation of large-scale education, welfare, and environmental programs that are designed and partially funded by the federal government and implemented by the states. Cooperative programs and expenditures roughly tripled between 1960 and 1980.[67] Throughout this period, co-

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count of federalism's historical development.

[64] BOOK OF THE STATES II, 143-44 (Council of State Governments and American Legislators' Association, 1937).

[65] *Id.*

[66] *Dual Federalism*, *supra* note 2, at 19.

[67] John E. Chubb, *The Political Economy of Federalism*, 79 AM. POL. SCI. REV.

operative federalism was sustained by a broad, bipartisan, liberal consensus. The federalism literature of those decades (in its public finance, policy analysis, and pluralist versions) was largely the literature of intergovernmental grants and relations. Most of it aimed to understand, expand, and marginally improve an unquestionably splendid system.

B. Brief Challenge

Around 1980, the cooperative consensus gave way to a much more critical assessment. The re-appraisal reached substantially beyond expert circles; it was reflected in the first Reagan Administration's 1982 "New Federalism" initiative.

One of the critics' dominant themes was that cooperative programs were neither coherent nor effective. The much-heralded "flexibility" of federally funded, locally administered programs, critics observed, is merely another word for policy slippage and "implementation deficits."[68] Instead of harmonizing national purposes and local autonomy (as the Progressives had hoped), cooperative programs were usually found to frustrate both. Even at a purely conceptual level, it is hard to see how it could be otherwise. By 1980, mounting empirical evidence buttressed the suspicion that even politicians cannot make two mutually exclusive principles—localism and nationalism—occupy the same policy space at the same time. On any given program, one or the other must give. In 1981, the congressionally-funded, non-partisan Advisory Commission on Intergovernmental Relations (ACIR) summarized its comprehensive review of cooperative federalism programs as follows:

> Regarding national purpose, the record indicates that federal grant-in-aid programs have never reflected any consistent or coherent interpretation of national needs . . .
>
> Regarding fiscal equity, the record indicates that federal aid programs have never consistently transferred income to the poorest jurisdictions or individuals. Neither do most existing grants accord with the prescription of "externality" theo-

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994, 994 (Dec. 1985).

[68] *See, e.g.*, JEFFREY L. PRESSMAN & AARON WILDAVSKY, IMPLEMENTATION (2d ed. 1979).

> ry . . . Regarding economic efficiency and administrative effectiveness, the record indicates . . . serious obstacles to the successful implementation of intergovernmental programs . . . .[69]

A second revisionist theme was the loss of political responsibility and accountability that invariably accompanies cooperative arrangements. The growth of federal responsibilities, the ACIR concluded, had produced "rising levels of political alienation, an increasing atomization of national political processes, and a growing overload of major decisionmaking institutions."[70] Since cooperative federalism separates program design from implementation, it also separates political initiative and authorship from responsibility for results. The accountability problem affects "unfunded mandates," which relieve the federal government of bearing the full (economic and political) costs of its programs; conditional grants programs and block grants, which enable the states to play with money they have not raised; and any combination of cooperative policies.[71] Let the cooperative regime metastasize long enough and drag enough interest groups and governments into its orbit, and in the end, no one is responsible for anything.[72]

The first Reagan Administration undertook a serious effort to disentangle cooperative federalism.[73] One of its first initia-

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[69] *See* THE FEDERAL ROLE IN THE FEDERAL SYSTEM: THE DYNAMICS OF GROWTH, *supra* note 58, at 94.

[70] *Id.* at 95.

[71] *See, e.g.*, Mark C. Gordon, *Differing Paradigms, Similar Flaws: Constructing a New Approach to Federalism in Congress and the Court*, 14 YALE L. & POL'Y REV. & YALE J. ON REG. (Symposium Issue) 187, 202 (1996); Hills, *supra* note 10, at 826 (characterizing block grants as unfunded mandates in reverse); Julie A Roin, *Reconceptualizing Unfunded Mandates and Other Regulations*, 93 NW. U. L. REV. 351, 381, 386 (1999) ("If intergovernmental mandates were funded, separation would remain between implementation and cost-absorption. Instead of being ordered to do things by a non-paying master, subordinate governments would now be in a position to choose means toward mandated ends unconstrained by costs.").

[72] "Where all responsibilities are shared, no one is truly responsible. And, if everyone is responsible for everything, no one can fulfill their obligations." *See* THE FEDERAL ROLE IN THE FEDERAL SYSTEM: THE DYNAMICS OF GROWTH, *supra* note 58, at 95.

[73] For a summary account of federalism during the early Reagan years see

tives was to consolidate seventy-seven federal programs into nine block grants in the Omnibus Budget Reconciliation Act of 1981. This consolidation, according to the OMB, reduced the paperwork imposed on state and local governments by 91 percent.[74] While these block grants merely modified, instead of eradicating, existing cooperative arrangements, the Administration subsequently embarked upon a more serious "decongestion" initiative. Its centerpiece was a 1982 proposal for a so-called welfare "swap": the federal government would assume full funding responsibility for Medicaid and the foodstamps program, in exchange for the states' assumption of full responsibility—including revenue responsibility—for other welfare programs (principally, what was then Aid to Families with Dependent Children).[75] While the terms of the swap were financially quite attractive to the states (since Medicaid payments were growing much faster than AFDC obligations), the proposal died an ignominious death. Neither the welfare lobby nor state and local officials were prepared to entertain the proposed segregation and separation of program responsibilities, principally for the pork-barrel and public-choice reasons discussed below.[76]

In the end, the New Federalism fell victim to the electoral interests of federal legislators, resistance of an entrenched intergovernmental bureaucracy, and the lack of Republican

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Timothy J. Conlan, *Ambivalent Federalism: Intergovernmental Policy in the Reagan Administration*, *in* ADMINISTERING THE NEW FEDERALISM 15 (Lewis G. Bender & James A Stever, eds., 1986).

[74] TIMOTHY J. CONLAN, FROM NEW FEDERALISM TO DEVOLUTION: TWENTY-FIVE YEARS OF INTERGOVERNMENTAL REFORM 200 (1998).

[75] For a thorough account of the origins and fate of the "swap" proposal see *id.* at 170-90.

[76] Conlan, *supra* note 73, at 181 ("State officials strongly supported federalizing Medicaid finance, but they opposed picking up the full costs of AFDC and foodstamps."); *id.* at 183-84 ("Many local governments were deeply suspicious of turning major program responsibilities over to the states, thereby severing their direct funding link to Washington."); *id.* at 183 (describing response from welfare lobby and Congress); *see infra* notes 132-34. Conlan suggests, at 190, that more general federal financing than the administration was willing to offer might have produced some compromise with state and local governments and perhaps the Congress. His narrative, however, makes it seem highly unlikely that the proposed segregation of functions could have been part of any such compromise.

control over the Congress.[77] By some measures, national control actually increased. The number of national regulatory provisions enacted during the 1980s—addressing everything from alcohol consumption to underground storage tanks to the asbestos removal—exceeded those of any other ten year period.[78] While these laws "had virtually no intelligible rationale for turning local concern[s] into a federal preoccupation[s],"[79] they were enacted without sustained White House objection. In addition, Congress re-categorized block grants and imposed new restrictions on federal funding programs.

In the face of centralizing pressures, the Reagan Administration abandoned its decongestion objectives and instead endeavored to stem the flow of federal money to state and local governments, with a fair measure of success. In constant dollars, federal grants-in-aid to state and local governments ceased to grow during the second Reagan administration and, net of ballooning Medicaid payments, actually declined.[80] Over the course of the Reagan era, federal funds as a percentage of state and local outlays dropped from 25.8% in 1980 to a low of 17.3% in 1989.[81]

C. Resumed Growth

After its consolidation during the Reagan years, cooperative federalism resumed its growth. Federalism reform ceased to be an important element of the executive agenda, and what little had been achieved under Reagan was quickly undone by drift and effort. Six major new statutory mandates were enacted between 1990 and 1994,[82] as was a substantial expansion

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[77] John E. Chubb, *Federalism and the Bias for Centralization*, *in* THE NEW DIRECTION IN AMERICAN POLITICS 273, 275, 286 (John E. Chubb & Paul E. Peterson. eds., 1985) (identifying centralizing forces and arguing that fundamental federalism reform is unlikely).

[78] CONLAN, *supra* note 74, at 259-60.

[79] Pietro S. Nivola, *Last Rites for States Rights?*, *Reform Watch Brief #1* (Brookings Institution, June 2000), *available at* http://www.brook.edu/comm/reformwatch/rw01/rw1.htm.

[80] CONLAN, *supra* note 74, at 219 fig. 11-1.

[81] Advisory Commission on Intergovernmental Relations, SIGNIFICANT FEATURES OF FISCAL FEDERALIST 30 (1994).

[82] Elementary and Secondary Education Act Amendments, 20 U.S.C. § 702

of the states' obligations under Medicaid. Along with new requirements came more federal money. "[F]ederal aid as a percentage of total state and local spending increased from 20% to 23% between 1990 and 1996."[83] The renewed growth of cooperative programs was accompanied by a lively political debate. In contrast to the early 1980s, however, the more recent, still-continuing debate extends only to the forms of cooperative programs, not to the broader question of their legitimacy or desirability. The relative fiscal discipline of the Reagan years, coupled with a gradual tightening of the regulatory screws under many federal programs (especially Medicaid), produced a furor among state and local governments over "unfunded federal mandates." Washington, D.C. proved receptive to those complaints. The Republican Party in Congress settled on a political program of "devolution," which calls for the transfer of regulatory functions and program administration to the states, while leaving policy guidance and fiscal responsibility in Washington, D.C. Devolution's watchwords, in other words, are more administrative autonomy, and more federal money, for state and local governments.

Devolution featured prominently in the House Republicans' 1994 "Contract With America."[84] It came to be reflected in the 1995 Unfunded Mandates Reform Act, which purported to impede the imposition of new mandates.[85] Devolution also

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(1996); Family and Medical Leave Act, 29 U.S.C. § 2601 (1993); National Voter Registration Act, 42 U.S.C. § 1973gg-1 (1993); Civil Rights Restoration Act , 42 U.S.C. § 1981 (1991); Clean Air Act Amendments, 42 U.S.C. § 7407 (1990); Americans with Disabilities Act, 42 U.S.C. § 12101 (1990).

[83] CONLAN, *supra* note 74, at 218-19. "Federal grant outlays increased more in four years under President Bush ($58 billion) than in eight years under President Reagan ($42 billion) . . . . [T]hey rose another $31 billion during President Clinton's first two years" in office. *Id.* at 218.

[84] On the federalism aspects of the "Contract with America" see JOHN DIIULIO, JR. & DONALD KETTL, THE CONTRACT WITH AMERICA, DEVOLUTION, AND THE ADMINISTRATIVE REALITIES OF AMERICAN FEDERALISM (1995).

[85] Pub. L. 104-4, 109 Stat. 48 (codified at 2 U.S.C. § 1501 *et seq.* (1994)). Most legal scholars argue that the Act has done very little, and will continue to do little, to impede new national mandates. *See, e.g.*, Elizabeth Garrett, *Enhancing the Political Safeguards of Federalism? The Unfunded Mandates Reform Act of 1995*, 45 U. KAN. L. REV. 1113, 1168 (1997) ("Virtually no one characterizes UMRA as the final word in the search for new and stronger political safeguards of federalism . . . . Assessments range from 'positive, if modest' to 'a hoax.'" (foot-

came to be embodied in the block-granting of several federal programs, including Medicaid and the 1996 welfare reform, which replaced individuals' federal entitlements to certain welfare payments with allocations to the states. It also transformed the categorical and assistance-oriented Aid to Families With Dependent Children program into a much more discretionary, welfare-to-work-oriented program called Temporary Assistance to Needy Families (TANF).[86]

When the 1996 reform appeared to have contributed to a substantial decline in welfare enrollments,[87] its success was widely, though erroneously,[88] attributed to its devolutionary elements, thus lending additional momentum to the block grant fervor. The Clinton administration and large segments of the Democratic Party in Congress initially resisted the block-granting of federal entitlement programs (including welfare reform), fearing that enhanced state discretion might diminish the clout of statutory beneficiaries and their organized advocates. These

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notes omitted)); Roderick M. Hills Jr., *The Eleventh Amendment as Curb on Bureaucratic Power*, 53 STAN. L. REV. 1225, 1239-40 (2001) ("The UMRA does nothing to address state agencies' incentives to collude with federal agencies and private litigants in a broad construction of federal mandates. . . ."); Daniel E. Troy, *The Unfunded Mandates Reform Act of 1995*, 49 ADMIN. L. REV. 139, 143 (1997).

[86] 42 U.S.C. § 601 (1996).

[87] *See, e.g.*, Douglas J. Besharov & Peter Germanis, *Welfare Reform—Four Years Later*, 140 PUB. INT. 17, 26 (reviewing and summarizing studies of welfare reform effects on declining case load).

[88] TANF's revolutionary character and the secret of its success lies not at all in the enhancement of state discretion (a routine, if periodic and usually temporary reform effort in many policy areas), but rather in the elimination of an individual entitlement to welfare. *See* 42 U.S.C. § 601(b) (providing that law "shall not be interpreted to entitle any individual or family to assistance under any State program funded under [the Act]." The Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Title I-Block Grants for the Temporary Assistance of Needy Families, Pub. L. 104-193, 110 Stat. 2104). The demise of individual entitlements, not block-granting, broke up the entrenched policy cartels of welfare rights activists and bureaucrats at the state, local, and federal levels that had theretofore impeded reform efforts. R. Shep Melnick, *Federalism and the New Rights*, 14 YALE L. & POL'Y REV. 325, 345-50 (1996); *see also* Martha Derthick, *American Federalism: Half Full or Half Empty?*, 18 BROOKINGS REV. 24 (2000) (stating 1996 welfare reform was as much about wresting power from federal courts as it was about encouraging state independence). Welfare reform, in other words, succeeded because cracked cooperative arrangements and the stranglehold of distributional coalitions on policy implementation.

fears, however, diminished over time, and the Administration cheerfully endorsed and promoted the block-granting of old programs and the creation of new ones: 100,000 federally funded cops,[89] more federally funded teachers,[90] a child health insurance program (called CHIP) for uninsured children outside the Medicaid program,[91] federal funds for school construction and battered women's shelters, and so on ad infinitum, or at least ad nauseam.[92] Individual programs or policy proposals invariably generate squabbles over funding levels, the stringency of federal requirements, and other particulars. Those skirmishes, however, take place within the confines of a broad, firm, bipartisan consensus on cooperative, block-grant federalism.

IV. THE COLLAPSE OF THE CASE FOR COOPERATIVE FEDERALISM

The political consensus on cooperative federalism stands in sharp contrast to the academic debate and literature. The cooperative federalism critique of the 1980s, exemplified by the ACIR Reports cited earlier,[93] has never been seriously contested, never mind rebutted. Even defenders of cooperative arrangements agree that cooperative federalism diffuses political accountability and responsibility.[94] They also agree that cooperative federalism's distributional effects lack rhyme or reason.[95] Good reasons support the ACIR's contention that the

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[89] Public Safety Partnership and Community Policing Act of 1994, 42 U.S.C. § 3796dd (1994).

[90] Goals 2000: Educate America Act, 20 U.S.C. §§ 5881-5883 (1994).

[91] State Children's Health Insurance Program, 42 U.S.C. § 1397aa *et seq.* (2000).

[92] 20 U.S.C. §§ 5888, 6031; Violence Against Women Act, 42 U.S.C. § 13701 (1994) and 42 U.S.C. § 13981 (2000).

[93] *See supra* notes 69-70 and accompanying text.

[94] *See* Hills, *supra* note 10, at 826-27; Roin, *supra* note 71, at 386 (defending unfunded mandates, but conceding accountability problems and noting even greater unaccountability under grants-in-aid programs).

[95] *See, e.g.*, Rodden & Rose-Ackerman, *supra* note 7, at 1559 (cooperative federalism "has evolved more as a self-interested political strategy than a conscious attempt to increase efficiency or fairness in intergovernmental relations.") International comparisons suggest that the equitable distribution problem is insolvable. *See id.* at 1559-60 ("Canadian intergovernmental transfers . . . may

impenetrability of cooperative federalism contributes to public cynicism and disaffection, that is, to citizens' sense that Washington cannot be trusted and that their votes do not matter.[96] To be sure, many federalism scholars, both in the legal and the political science profession, take cooperative federalism for granted, if for no better reason than its familiarity and pervasiveness.[97] And of course, individual cooperative programs have found defenders. However, *no coherent defense of cooperative federalism as a basic political arrangement is available.*

In this crucial respect, the academic debate differs from the 1960s, when cooperative federalism sailed under public-spirited banners. Supposedly, intergovernmental cooperation served to prevent interstate externalities, to aid redistribution, to avert a fiscal crisis of the states and to enhance localism and flexibility. All four justifications, however, have proven untenable. Actual cooperative practices fail to correspond to the theoretical justifications.[98] Scholars who are quite sympathetic to

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actually be more appropriately described as pork-barrel politics than as efficiency-enhancing attempts to stabilize intergovernmental competition."). *See generally* HERMAN BAKVIS, REGIONAL MINISTERS: POWER AND INFLUENCE IN THE CANADIAN CABINET (1991). As noted *supra* note 31 and accompanying text, the German Constitutional Court's 1999 ruling on the Financial Constitution determined that financial compensation, as currently practiced, bears no relation to constitutional mandates of equity, fairness, and solidarity. That assessment reflects a unanimous consensus among experts.

[96] The proportion of Americans who believe that the government in Washington can be trusted "to do what is right" only some or none of the time shot from 22% in 1964 to 61% a decade later and, with the exception of a few months during the Reagan administration, has remained above—occasionally far above—50% since. EVERETT CARL LADD & KARLYN BOWMAN, WHAT'S WRONG: A SURVEY OF AMERICAN SATISFACTION AND COMPLAINT 105-08 tbl. 5-20 (1998) (tabulating survey responses 1958-1998). While there is no direct line from cooperative federalism to civic discontent, the sustained high level of distrust-through good economic times and bad, war and peace, scandals and calm-strongly suggests a connection to structural features of national politics.

[97] *See* GREVE, *supra* note 11.

[98] These objections also apply, with equal force, to attacks on competitive federalism that provide an implied defense of cooperative federalism. Notably, "race-to-the-bottom" theorists that attempt to model competitive federalism as a prisoners' dilemma (such that competition for industry induces states to provide sub-optimal levels of public goods, *see, e.g.*, Daniel C. Esty, *Revitalizing Environmental Federalism*, 95 MICH. L. REV. 570, 603-04 (1996)) have come under heavy criticism as lacking theoretical plausibility and empirical support. *See, e.g.*, Jona-

cooperative federalism's ostensible objectives (notably redistribution) concede and indeed argue that cooperative federalism's growth has little to do with public-spirited objectives and is better understood as an accommodation to political and interest group demands.[99]

A. Externalities

If states are able to inflict a portion of their activities on sister-states, they may undersupply regulation (as when air pollution from unregulated facilities blows into downwind states). Alternatively, they may oversupply regulation, as when the costs of regulatory experiments fall on non-citizens. State-federal cooperation, the traditional argument goes, can and should counteract the attendant inefficiencies. The argument, however, is subject to two forceful objections.

First, any attempt to combat externalities through cooperative means, especially federal subsidies, creates either substantial welfare losses or moral hazard problems (or both). Subsidies for all states (externalizers and good citizens alike) produce unwarranted redistribution and associated deadweight losses; subsidies for "bad" states only induce heretofore good states to go bad, or to threaten to go bad, so as to attract the otherwise unavailable subsidy. Externalities may justify a system of centrally coerced, horizontal compensation payments;[100] they may also justify centralization in the form of

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than H. Adler, *The Ducks Stop Here? The Environmental Challenge to Federalism*, 2001 SUP. CT. ECON. REV. (forthcoming 2001) (reviewing literature and evidence); Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race-to-the-Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210, 1233-44 (1992) [hereinafter *Rehabilitating Interstate Competition*]; Richard L. Revesz, *The Race to the Bottom and Environmental Regulation: A Response to Critics*, 82 MINN. L. REV. 535, 563-64 (1997). Note, moreover, that even a persuasive critique of competitive federalism does not necessarily establish a case for cooperative arrangements; centralization may often be a more plausible option. *See infra* notes 105, 111 and accompanying text.

[99] Rodden & Rose-Ackerman, *supra* note 7, at 1554, 1559.

[100] The appeal of such horizontal compensation payments is mostly theoretical. In practice, the difficulty of calculating externalities and compensation payments-in an intensely politicized, interest-group-dominated environment-will render most such policies counterproductive.

direct federal regulation. They are a lousy argument for cooperation.

The externality argument typically assumes, moreover, that the federal government will be immune to the interest group pressures that produced the state-level externalities in the first instance.[101] That assumption is mildly described as unrealistic. The lack of realism (and this is the second objection to the externality argument) is measured by the harsh fact that the federal government creates vastly more interstate externalities than remedies. Very few environmental regulations, for example, are targeted at the prevention of interstate pollution.[102] Most address purely local matters and, in the process, often compel massive wealth transfers from some states to others.[103] The observed pattern is a resolute congressional unwillingness to remedy state externalities, coupled with a cheerful imposition of federally produced externalities.

B. Redistribution

"Pure" models of local expenditures, in the tradition of Charles Tiebout, predict that competing jurisdictions will under-supply redistributive policies.[104] Because the expropriated citizens in such schemes tend to vote with their feet, jurisdictional competition will induce each jurisdiction to pursue less income redistribution than it would supply if it were alone in

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[101] GEOFFREY BRENNAN & JAMES M. BUCHANAN, THE POWER TO TAX: ANALYTICAL FOUNDATIONS OF A FISCAL CONSTITUTION 181-82 (1980) (conventional arguments for centralization, including redistribution, are typically based on "benevolent despot" assumption of national authority).

[102] Thomas W. Merrill, *Golden Rules for Transboundary Pollution*, 46 DUKE L.J. 931, 933-34 (1997).

[103] Air pollution in Los Angeles, for example, remains mostly confined to the Southern California air basin, yet federal mobile source controls (that is, automobile tailpipe standards) effectively compel Montana ranchers to subsidize, through higher car prices, pollution abatement in Beverly Hills. There may be reasons for asking dirt farmers to provide relief for movie moguls, but externalities are not among those reasons. *See* BRUCE ACKERMAN & WILLIAM T. HASSLER, CLEAN COAL, DIRTY AIR (1981) (describing how coalition of environmental groups and high-sulfur coal producers successfully lobbied for federal regulatory regime with massive transboundary externalities).

[104] Charles M. Tiebout, *A Pure Theory of Local Expenditure*, 64 J. POL. ECON. 416, 422 (1956).

the world. Hence, the need for federal intervention.

It is no doubt true that jurisdictional competition will, under any set of realistic assumptions, inhibit redistribution. The inhibition, though, runs not only against equity-oriented redistribution from rich to poor but also against the accommodation of "naked" preferences and rent-seeking. Since it is exceedingly difficult to imagine, let alone implement, an institutional arrangement that will permit "good" redistribution while screening out the bad kind, redistributionists must justify competition-trumping, federal intervention even at the price of buying more of the bad stuff.[105] Assuming, *arguendo*, that challenge can be met, redistribution demands outright centralization rather than cooperative federalism. There is no reason to believe that income or wealth differences across states correspond in any systematic fashion to differences among individuals. The solution to this "obvious problem" is to accomplish redistributive purposes directly (for example, through federal tax policy).[106]

The same conclusion follows from a political perspective. If welfare programs, for example, are intended to redistribute income from rich to poor, it seems ill-advised to let bureaucrats and politicians in, say, Alabama monkey with benefit levels and eligibility requirements (as cooperative schemes permit them to do). If Washington, D.C. has a national responsibility for the poor (as federal grants would indicate), it ought to ensure that the funds reach the intended beneficiaries, in the

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[105] For a similar argument, see Peter H. Schuck, *Some Reflections on the Federalism Debate*, 14 YALE L. & POL'Y REV. 1, 18-20 (1996) (state competition inhibits rent-seeking and may thus be worth having even if it induces states to undersupply public goods). The insight that institutional analysis should look to the general tendency of preventing "partial" laws—even at the risk of defeating good ones—is the Founders'. THE FEDERALIST NO. 74, at 444 (Alexander Hamilton) (Clinton Rossiter ed., 1962) (objection that constitutional obstacles might prevent enactment of good laws "will have little weight with those who can properly estimate the mischief of that inconstancy and mutability in the laws, which form the greatest blemish in the character and genius of our governments. . . . The injury which may possibly be done by defeating a few good laws will be amply compensated by preventing a number of bad ones.").

[106] Jack H. Knott, *Stabilization Policy, Grants-in-Aid, and the Federal System in Western Germany*, *in* THE POLITICAL ECONOMY OF FISCAL FEDERALISM, 75, 79 (Wallace E. Oates ed., 1977).

intended form. If no national responsibility exists, the rationale for federal subsidies disappears.[107]

C. The Fiscal Crisis of the States

Whatever one makes in the end of the redistributive case for cooperation (if indeed there is such a case), its force is greatly diminished by the fact that cooperative policies only rarely serve redistributive purposes. Most frequently, we put cooperative federalism to work for the procurement of public goods—environmental quality, roads, crime prevention and education (a private good, but one with strong public goods attributes).[108]

Pure theory provides no reason to believe that state jurisdictions will under-supply public goods. Rather, competing jurisdictions will generally supply optimal levels of public goods at different levels (along with tax packages to finance those goods).[109] Mobile citizens will sort themselves into the jurisdiction that best suits their tastes and needs, and get what they pay for.[110]

The cooperativist objection is that the feds have the money

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[107] Gordon, *supra* note 71, at 214-15.

[108] Chubb, *supra* note 77, at 281; *see also supra* note 8 and accompanying text.

[109] I leave aside problems of scale, network externalities and jurisdictional "bottlenecks." First, these problems are better understood in terms of externalities, rather than "race to the bottom" or public goods terms. *See Rehabilitating Interstate Competition*, *supra* note 98, at 1210, 1222-23 (noting confusion between two types of problems). *But see* Solid Waste Ass'n v. United States Army Corps of Eng'rs, 531 U.S. 159, 179 (2001) (Stevens, J., dissenting) (citing Revesz article but promptly confusing externality and "race to the bottom" problems). Second, even the most "dual" of federalists will concede that the problems just listed warrant federal intervention as a matter of (economic and constitutional) principle. *See, e.g.*, Richard A. Epstein, *The Proper Scope of the Commerce Clause*, 73 VA. L. REV. 1387, 1420 (1987). Whether cooperative federalist arrangements are actually prompted by the aforementioned problems and conducive to their efficient resolution is a different question, to which the answer is "no." Edward A. Zelinsky, *Unfunded Mandates, Hidden Taxation, and the Tenth Amendment: On Public Choice, Public Interest, and Public Services*, 46 VAND. L. REV. 1355, 1414-15 (1993); *id.* at 1389-96 (posing externality-based "public interest" model); *id.* at 1408-09 (rejecting that model as based "on particularly heroic assumptions").

[110] The observation that real states and citizens do not operate under conditions of perfect civic mobility is accurate, but it tends to suggest that states will overtax and overregulate.

to provide public goods and that the states do not.[111] The argument merits discussion solely on account of its political appeal, which it shares with every free-lunch theory of government. State politicians must consider the costs and benefits of contemplated policy schemes. Cooperative schemes do not abolish those trade-offs. They do, however, obscure them, because the money that pours into a state is far more visible than the tax dollars that have departed to Washington to finance those schemes. For eighteen long years, New Yorkers admired Alfonse "Senator Pothole" d'Amato for bringing home the bacon, without ever realizing that they have been perennial suckers in the cooperative federalism scheme.[112]

Too schooled to fall for a simple fiscal illusion, economists have fallen for the more sophisticated claim that state and local governments—competing, as they must, for productive citizens—cannot rely as heavily as the national government on (progressive) income taxes. In a growing economy, the relative income inelasticity of state tax systems is said to create a systemic revenue shortfall for the states.[113] This argument had political force, especially during the 1960s and 1970s, when general revenue sharing was widely viewed and justified as a means of pumping excess federal revenues back into the economy.[114] Even apart from its many implausible premises and implications, however,[115] the argument fails to make the case

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[111] Random example: "We've got some money now, and a lot of states and localities don't, but there's no better way to spend it than investing in our children's future." *Clinton Pressures GOP on Federal Role in Education*, WASH. POST Aug. 24, 2000, at A7 (quoting then-President Clinton's comments on then-pending federal education proposals).

[112] Leonard & Walder, *supra* note 58, at 116, tbl.C-6 (over seventeen-year period beginning in 1983, New York ranked forty-eighth among fifty states, and forty-third on a per capita basis, in its federal balance of payment, with a net loss of $252 billion).

[113] WALTER W. HELLER, NEW DIMENSIONS IN POLITICAL ECONOMY 118 (1966) ("At the Federal level, economic growth and a powerful tax system, interacting under modern fiscal management, generate new revenues faster than they generate new demands on the Federal purse. But at the state-local level, the situation is reversed. Under the whiplash of prosperity, responsibilities are outstripping revenues.")

[114] WILDAVSKY, *supra* note 32, at 60.

[115] The argument implies that states should support the federal government in times of recession; to my knowledge, no serious economist has urged such a reces-

for cooperative federalism. If the states lack money, and the feds have too much of it, why not enact a federal tax cut instead of an intergovernmental grant? So long as the citizens' interests are in harmony with the local politicians', either measure should raise local spending by equal amounts, depending on the income elasticity of demand. If a $10 federal tax cut would increase local spending and taxes by $1, a local government that reflects its citizens' interests would retain $1 of a $10 revenue-sharing grant and pass on the remainder in the form of a local tax cut.[116]

That, of course, is not going to happen. Local governments will keep the revenue-sharing cash, even while they would not dream of enacting an equivalent tax hike. Economists call this the "flypaper effect": the money sticks where it hits.[117] The real effect of federal grant programs is to finance intergovernmental bureaucracies and policy cartels at the state and local level.[118] These constituencies can in turn be relied on to lobby for increased federal funding and to thwart reform efforts.

D. Flexibility

Intergovernmental cooperation, it is often argued, offers flexibility, room for state experimentation and opportunities to tailor federal programs to the differing needs and circumstanc-

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sionary return to the Articles of Confederation. In addition, the argument is based on the debatable assumption that taxpayers will respond to increases in local tax *rates* but not to increased tax *burdens*. *See* Wallace E. Oates, *An Economist's Perspective on Fiscal Federalism*, *in* THE POLITICAL ECONOMY OF FISCAL FEDERALISM, *supra* note 106, at 3, 16-17. I leave aside the underlying assumptions and implicit empirical claims concerning local and federal tax elasticities, all of which are contestable.

[116] Edward M. Gramlich, *Intergovernmental Grants: A Review of the Empirical Literature*, *in* THE POLITICAL ECONOMY OF FISCAL FEDERALISM, *supra* note 106, at 225.

[117] Gramlich credits the terminology to Arthur Okun. *Id.* at 226 n.5. For a general exposition see William A. Niskanen, *The Peculiar Economics of American Bureaucracy*, 58 AM. ECON. REV. 293 (May Supp. 1968).

[118] John E. Chubb, *supra* note 77, at 295-96 (documenting "strong" evidence that national government has promoted growth of state and local government); PAUL C. LIGHT, THE TRUE SIZE OF GOVERNMENT 35-36 (1999) (estimating federal-mandate-induced state and local government work force at 4.6 million, out of 13.1 million total).

es of the various states.[119] Empirical studies, as noted, counsel considerable skepticism concerning the compatibility of state-level flexibility and preference accommodation with policy coherence and effectiveness.[120] That aside, the larger question is, flexibility and experimentation compared to what? The point of grafting cooperative arrangements onto dual federalism is to reduce the range of policy options that are available to the states and to enlist the states in the pursuit of common, national goals that at least some of them would not otherwise pursue.[121] Regardless of their merits, federally funded, state-administered welfare programs effectively deprive the citizens of some states of the option of not having those programs, thus rendering the world less experimental, flexible and citizen-friendly. The experimentation-and-flexibility argument, in other words, gains plausibility only from its baseline comparison with a wholly centralized, unitary system, rather than the still more variegated world of dual federalism.

E. The Real Case for Cooperative Federalism

The one thing cooperative federalism reliably produces is a big, sprawling government. The assertion is buttressed by experience (the growth of cooperative federalism has always coincided with the growth of government) and by numerous analyses, any one of which of suffice to explain the phenomenon. James Buchanan and others have shown that national spending on local issues will produce spending levels in excess of anybody's preference.[122] Political scientists, such as the late Aaron Wildavsky, have argued persuasively that increases in government spending at all levels provide the only way of solving

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[119] Perhaps the classic formulation of this view is Morton Grodzins, *The American System: A New View of Government in the United States*, 62-64 (1966).

[120] *See supra* notes 68-69 and accompanying text.

[121] The New Deal viewed cooperative entanglements as a means of providing states with the "freedom" to pursue policies that might otherwise be inhibited by horizontal competition. *See, e.g.*, Chas. C. Steward Mach. Co. v. Davis, 301 U.S. 548, 587-88 (1937); *see also* Corwin, *supra* note 2, at 21. Today, this "competition is coercion, dependency is freedom" argument sounds quaint, and I have not found it anywhere in the modern literature.

[122] JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT 135-40 (1962).

distributional conflicts among government institutions.[123] Basic public choice theory, briefly discussed below,[124] explains cooperative policies as a form of hidden, and hence excessive, taxation.

On these tendencies rests the only plausible argument for cooperative federalism. A modern society, the cooperativist might say, demands a bigger government than a competitive, dual, constitutional federalism will permit. It may be true that cooperative policies diffuse political responsibility, accountability and transparency. America's constitutional and political culture, however, renders the option of outright centralization effectively unavailable. For all its flaws, then, cooperative federalism is the only available means to the necessary end of expanding the reach of government. The incoherent pursuit of national ambitions is preferable to a nightwatchman state; more redistribution, even if erratic, is still better than less. It is not the fault of political reformers, from the Progressives on forward, that we are stuck with a half-hearted, incoherent socialism and with "centralization with a human face."[125] The fault, rather, lies with America's archaic constitutional traditions.

If that is the foundation upon which cooperative federalism's defenders wish to rest, they should say so. Few, if any, have.

V. Cooperative Federalism's Political Attractions

The traditional, public-interest justifications for cooperative federalism have collapsed. The twenty-year-old ACIR critique of cooperative federalism as ineffectual, inequitable and irresponsible has lost none of its plausibility. Cooperative policies are widely viewed as ineffectual, both by the public and among experts; education policy in particular is characterized by a general sense of failure. Cooperative schemes continue to

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[123] *See supra* note 32.

[124] *See infra* notes 127-37 and accompanying text.

[125] This splendid description of cooperative federalism is Aaron Wildavsky's: "Federalism and Inequality," in Federalism and Political Culture, *supra* note 32, at 39, 52.

mushroom, however, and in sharp contrast to the 1980s, scholarly critiques of cooperative federalism—along with burgeoning literature on the attractions of a more competitive federalism[126]—are falling on deaf ears. Ironically, Ronald W. Reagan's New Federalism agenda attracts respect and support among liberal policy analysts—and resolute opposition from Republican (and for that matter Democratic) government officials at all levels.[127] What happened?

The answer is that the question misses the point. As already suggested, and further sketched in the first half of this section, cooperative federalism is extremely attractive to organized interests and to politicians at all levels. Cooperative federalism's growth in many countries and, in America, under a wide variety of political, fiscal and economic conditions, strongly suggests that it is driven and sustained by basic public choice dynamics, rather than contingent political and economic factors.[128]

Contingent factors, however, render cooperative federalism more or less resilient to political challenge at any given point in time. Such factors may also shape the forms of cooperative federalism. The second half of this section sketches factors that, over the past decade, have rendered "devolutionary," block-grant federalism particularly appealing.

A. Public Choice

In a widely cited, quibbled-with but unrebutted article, Edward A. Zelinsky has explained the pervasive phenomenon of "unfunded mandates" as an application of the familiar story of concentrated benefits and dispersed costs, played out under conditions of rational voter ignorance, costly and hence imperfect monitoring of governmental agents (at all levels), and in-

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[126] *See, e.g.*, sources cited *supra* notes 3, 6; GORDON TULLOCK, THE NEW FEDERALIST (1994).

[127] Liberal policy experts and think tanks continued to endorse the Reaganite welfare "swap" long after its failure. *See, e.g.*, Ed Kilgore & Kathleen Sylvester, Blocking Devolution: Progressive Policy Institute Policy Briefing (Feb. 16, 1995) (endorsing welfare swaps as "progressive alternative" to half-hearted devolution) *at* http://www.dlcppi.org/text/social (last visited Jan. 29, 2001).

[128] Zelinsky, *supra* note 109, at 1363-64.

formation asymmetry between average voters and organized interests.[129] An unfunded mandate is a rational political response when a distributional coalition[130] has sufficient clout to enact its demands in some states—but not in all states, and not at the federal level. Suppose, by way of an actual example, that some states adopt an expensive health insurance program for previously uninsured children. The coalition that succeeded in enacting the state programs will press for national legislation. States that have already acceded to the demand will join the campaign for national intervention, both to offset their marginal disadvantage vis-a-vis competing states and with an eye towards transferring a portion of the visible cost to the national government. Federal legislators who would vote against the measure if the full costs appeared in the federal budget may vote for a mandate that hides the costs in state and local budgets. If their votes are required to enact the program, the spending coalition will take the unfunded mandate as the best it can get.

While state politicians may chafe under the mandates, they will often be divided, and their opposition will typically be ineffectual because, among other things, it will be interpreted as opposition, not to the mandate and the lack of full federal funding but to the policy itself.[131] That policy, meanwhile, will look much more appealing to citizens, even and especially in previously anti-spending states, once federal intervention has obscured the cost-benefit trade-off: few citizens will make the connection between higher state taxes and federal mandates. State and local efforts to impress the connection on their constituents will generally be futile.[132]

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[129] *Id.*

[130] This terminology is more widely used than Zelinsky's "pro-service constituency." *See* Weingast, *Political Institutions*, *supra* note 6.

[131] As Zelinsky explains, "there is force to this characterization," since the effective alternative to the under-funded oversupply of federal regulation is often no supply at all. Zelinsky, *supra* note 109, at 1387. Moreover, since local officials depend on central legislators for appropriations, opposition to federal mandates typically takes the form of diffuse complaints about legislature generically, rather than targeted campaign at individual legislators. *Id.* at 1386.

[132] *Id.* at 1374-75.

States may occasionally oppose pure unfunded mandates—that is, federal commands that are unaccompanied by any federal funds. Even in such instances, however, the states' opposition will be tempered by their exposure to the coalition that successfully lobbied for the federal mandate. In any event, and perhaps due to anticipated state opposition, outright federal "commandeering," i.e., the direct imposition of federal mandates that apply only to state and federal governments, is a rare phenomenon.[133] Most federal mandates are accompanied by federal funds that are sufficient to induce pro-spending jurisdictions to surrender control over their programs and to induce previously anti-spending jurisdictions to accept the program.

Less—much less—than full funding will typically do the job. Even in the face of extraordinarily burdensome mandates or grant conditions, the rational state will rarely lobby for the abolition of the program. Any such effort would entail massive coordination problems with sister-states, resistance from pro-spending interests and possible retaliation by federal legislators. Nor will that state endorse the transfer of full federal spending and policy authority to the federal government. A federal monopoly would deprive state politicians of the opportunity to purchase the good graces of state-level interest groups with federally subsidized dollars. No: the rational state will join hands with sister-states and with pro-spending lobbies to demand increased federal funding. Likewise, the rational federal legislator will prefer some form of cooperation both to a wholly national program, which would entail full responsibility for costs and potential failures, and to no program at all. There, lo and behold, goes the Reaganite welfare swap: propose to replace a tangled system with a mix of exclusive state and national responsibilities, and everyone is against it.

Note that the partial federal funding of mandates does nothing to remedy the agency and accountability problems, and may in fact exacerbate them. The creation of a federal conditional spending program, in lieu of an underfunded mandate, simply means that the distributional coalition has deemed it

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[133] Printz v. United States, 521 U.S. 898, 925 (1997).

fit, or necessary, to bribe rather than coerce previously non-participating states or, as the case may be, to compensate citizens in service-providing states to surrender a portion of their autonomy.[134] A grant-in-aid, no less than an unfunded mandate, is a form of hidden taxation. Citizens will experience the grant as a subsidy to their state, without being able to trace the portion of their federal tax bill that is devoted to the program in question. The grant will typically amount to less than the full cost of the program, thus providing the illusion that the federal government is providing a lot for little money. Here as in the unfunded mandates case, the states that must provide the "missing" funds will be unable to persuade voters of the link between their state tax bill and the federal failure to provide full funding. Here as there, states will be unable to bolt, for the reasons noted, and because each state's voter will be compelled to pay a portion of the federal funds irrespective of the state's participation. Push the argument and the policy further, and let the federal government pay the full cost of the cooperative program: now, the agency and monitoring problems rear their ugly heads, not between the taxpayer and the federal government but between the feds and the locals, who will divert the federal funds to unintended uses.[135]

The terms of intra-governmental bargains vary from issue to issue and time to time, depending on interest group constellations and exogenous factors such as general fiscal conditions at the state and federal level. The bargaining may take place

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[134] Zelinsky, *supra* note 109, at 1378-80.

[135] Julie A. Roin, *Reconceptualizing Unfunded Mandates and Other Regulations*, 93 NW. U. L. REV. 351, 353-54 (1999) (noting that payment-for-services schemes pose moral hazard problems that may render them inferior to unfunded mandates). That point is well taken, as is Roin's objection to any "special criticism reserved for unfunded mandates" among all cooperative schemes. *Id.* at 375. Then, the argument goes astray. Roin rejects the belief that "Congress would pass the same intergovernmental mandates if it were forced to pay for them," and ascribes that reluctance to "legitimate concerns about the dangers of providing state and local governments with open-ended funding." *Id.* at 387. The binary choice between funded and unfunded mandates, however, does not exhaust the policy universe. A third option is to have the federal government itself fund and enforce its mandates, with its own bureaucrats. That option would obviate agency and accountability problems, but Roin does not contemplate it. Her position, like Hills', rests on narrowing the range of options to cooperation.

along other dimensions in addition to the vertical distribution of funds (for instance, funding formulas that determine the states' proportional share in the costs and benefits, or the scope of the states' residual regulatory autonomy under the federal program). But these complexities and qualifications merely concern the relative bargaining position between government actors, not the basic analysis or, for that matter, the citizen's position vis-a-vis the intergovernmental machinery.[136] Any form of cooperative federalism will reduce the range of policy variation among the states and deprive citizens of the benefits of diversity and choice; produce taxation that is hidden and therefore in excess of the voters' actual preferences; reduce political transparency; obscure political responsibility; and facilitate political blame-shifting.

B. The Forces for Block Grants

The agency problems that cause cooperative federalism's pathologies also make it attractive to politicians at all levels. But while politicians will almost always find cooperative federalism preferable to its competitive cousin, the intensity with which they do so, and the forms that find political favor, depend on extraneous circumstances. Both in Germany and here, challenges to cooperative federalism have coincided with exogenous shocks (reunification, the aftermath of the oil crisis). Federal budgetary conditions appear to play a role, with tight constraints pushing towards unfunded mandates and federal plenty, towards block grants.[137] Ideology and the mobilization of interest groups may also influence the equation: small-government ideology plainly influenced the Reagan administration's New Federalism agenda.[138] Broad social and

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[136] *See* Wildavsky, *supra* note 32, at 58-59; *see also* PAUL E. PETERSON ET AL., WHEN FEDERALISM WORKS 22-23 (1986) (noting difference between block grants and categorical grants is often illusory).

[137] *See, e.g.,* Wildavsky, *supra* note 32, at 60. Zelinsky, *supra* note 109, at 1363-64, notes the popularity of budgetary explanations of unfunded mandates but criticizes them as insufficient. As noted in the text, I agree with Zelinsky's view that public choice dynamics provide a more fundamental explanation. Still, as Zelinsky observes, fiscal constraints appear to play some role in explaining the forms of cooperative federalism. Zelinsky, *supra* note 109, at 1363-64.

[138] Carol Matlack, *What Reagan Promised, What Reagan Delivered*, 20 NAT'L J.

political trends may push the system to the extreme of unfunded mandates or towards the opposite extreme of funded non-mandates (i.e., block grants). Over the past decade, several forces have pushed towards the latter: the localization of American politics; enhanced social and economic mobility; and the increased heterogeneity—along ideological dimensions—among the various states.[139]

C. Localization

American politics has gone local, in the sense that most of the issues that citizens care about, from crime to education to suburban sprawl, are local in nature. President Clinton had splendid ideas as to where children should go to school and what they should study, eat and wear while there. So does President Bush. All this, though, is the stuff of school board or PTA meetings. Short of turning America's education system into France's, there isn't much the federal government can do—except to toss money on the street for this, that or the other education initiative. Devolutionary cooperative federalism is a functional response. Perhaps, the only such response.

D. Mobility

In a competitive federal republic, the citizens' ability to vote with their feet disciplines subordinate governments. The power of exit rights correlates inversely with the cost of exercising them; and, over the past decade, those costs have plummeted. Unlike, say refineries or manufacturing plants, dot-com or software companies can move with relative ease in search of a hospitable environment. Increased wealth means increased mobility: pesky, previously poor New Yorkers purchase cars, drive them to Jersey City and return with low-tax contraband, thus forcing New York to introduce tax-free shopping days.

1298 (May 14, 1988).

[139] I am uncertain about the relative weight of the listed variables and their interaction, and additional factors may have played a role in block grant federalism's ascent. In short, I make no theoretical pretension, and claim no more than plausibility.

Technology does its part: the Internet hasn't created sales tax avoidance, but it has put that option within the reach of additional millions of consumers.

Under conditions of perfect mobility, there will still be state taxes, equivalent to a user fee for public services. Politicians, however, are interested in the distributable fiscal residuum over and above that level,[140] and enhanced mobility is diminishing the residuum. Short of the usually unavailable option of increasing exit costs, the states have only two means of enhancing political rents: cartellization (such as the multi-state tobacco agreement[141] and on-going efforts to establish an Internet sales tax cartel),[142] and increased transfer payments from the near-monopolistic federal government. The latter strategy in turn implies a demand for a larger role in the implementation of federally financed programs, lest state officials be rendered wholly impotent and obsolete. "More dollars for more autonomy" is the official agenda of the National Governors' Association and its sister lobbying organizations—always and consistently, but especially under conditions of enhanced mobility.[143]

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[140] The term and the agreement are James M. Buchanan's. *See* Buchanan, *Federalism and Fiscal Equity*, 40 AM. ECON. REV. 583 (1950).

[141] *See* National Association of Attorneys General: Master Settlement Agreement and Amendments, http://www.naag.org/tobaccopublic/library.cfm; *see also* THE MULTISTATE MASTER SETTLEMENT AGREEMENT AND THE FUTURE OF STATE AND LOCAL CONTROL, Tobacco Control Resource Center, Northeastern University School of Law (Graham Kelder & Patricia Davidson, eds., 1999), *available at* http://www.tobacco.neu.edu/msa/msa_analysis.pdf.

[142] On the states' attempts to expand jurisdiction over internet commerce see Jeanne Anne Naujeck, *Maryland's Support for Internet Sales Tax a Tough Sell*, ASSOCIATED PRESS STATE & LOCAL WIRE, Feb. 14, 2001; *see also* Howard Gleckman, *Business Online: A First Attempt to Cut the Sales Tax Tangle*, http://www.businessweek.com/bwdaily/dnflash/sep2000/nf20000921_589.htm (last visited Feb. 20, 2001).

[143] *See, e.g.*, The National Governors' Association's position, http://www.nga.org/nga/legislativeUpdate/1,1169,C_POLICY_POSITION^D_482,00.html (last visited Feb. 2001).

E. Two Cultures

Zelinsky has argued that greater homogeneity among jurisdictions should be expected to increase pressure for unfunded mandates.[144] A distributional coalition that first prevails in some states and subsequently "goes national" with its demands will have a large number of adherents even in the states where it cannot prevail. Thus, little federal funding is required to induce acceptance of the mandate. Conversely, jurisdictional heterogeneity should be expected to push towards block-granting and more generous funding: more money and broad policy discretion are the price of inducing "dissident" jurisdictions and their representatives at the national level to accept the federal program.

Sam Peltzman showed some time ago that increased economic homogeneity among the various states has gone in tandem, paradoxically, with increased political, ideological heterogeneity among regions, and he predicted a continuation of this trend.[145] Circumstantial evidence, especially the 2000 elections, which appear to indicate a sharp cultural divide among states and regions,[146] is broadly consistent with Peltzman's analysis and prediction. This may help explain the increased popularity and generosity of federal block-grant policies especially in areas with pronounced cultural and ideological implications, such as education, welfare and crime.

A variation of this argument suggests that devolutionary block-grant federalism benefits from a sharp but narrow ideological division at the national level, coupled with relatively loose budgetary constraints. Suppose Republicans introduce a $25 billion education bill, with funding conditions written by the Family Research Council. Suppose further that Democrats counter the offer with a $35 billion proposal, with funding conditions written by the teachers' unions. The legislative equi-

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[144] Zelinsky, *supra* note 109, at 1387-88.

[145] Sam Peltzman, *An Economic Interpretation of the History of Congressional Voting in the Twentieth Century*, 75 AM. ECON. REV. 656 (1985).

[146] *See, e.g.*, Terry Teachout, *Republican Nation, Democratic Nation?*, COMMENTARY 23 (Jan. 2001).

librium point is to strip both sets of conditions and to negotiate a financial compromise somewhere in the range of $50 billion.[147]

It is only partially correct to view legislative deals along these lines as a simple monetization of ideological disagreement; "devolution" itself is a way of papering over those disagreements. Unlike the Reaganite commitment to disentanglement and dual federalism, which implies a set of libertarian, small-government values, "devolution" is consistent with a broad set of political values.[148] Confused conservatives think devolution means federalism. Progressives and Third Way politicians fantasize about "reinventing government"[149] and about squaring the circle of national purposes and local autonomy. Liberals view more federal money as yet another opportunity to accommodate their clientele and to discredit conservatives as stingy and heartless. Unreconstructed Leftists can accept devolution, since it promises to maximize the aggregate revenues and coercive capacity of government at all levels.

The devolutionary compromise frays when the money runs out or else, when one side or the other decides to approach federalism questions from a broader, more ideological perspective—and has a sufficient political majority to carry the day. The present political conditions, of course, are precisely the opposite.

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[147] The compromise financial bargain will tend to be higher than the opening bids because the distributional coalitions that would benefit from a categorical grant will discount the value of a block grant in proportion to the risk that local bureaucracies might "abuse" their discretion to the coalition's disadvantage.

[148] Aaron Wildavsky, *Federalism Means Inequality*, *in* FEDERALISM & POLITICAL CULTURE, *supra* note 32, at 39, 49. Originally published in 22 SOCIETY 42 (Jan./Feb. 1985) (i.e., before the term "devolution" gained currency), the article refers to "decentralization."

[149] On the political incentives to "reinvent" the federal government by pushing functions and jobs into a "shadow government" of state and local bureaucrats and private contracting organizations see PAUL C. LIGHT, THE TRUE SIZE OF GOVERNMENT (1999). *See id.* at 11 ("The shadow of government . . . gives Congress new opportunities to claim credit for jobs created back home, while assuring a steady source of campaign financing. It also allows Democrats to reposition themselves as the party of bureaucratic reform . . . "); Wildavsky, *supra* note 148, at 65-66 (discussing decentralization under Vice President Gore's "Reinventing Government" initiative).

VI. Political Reform? Constitutional Constraints?

Cooperative federalism, I have argued, compromises constitutional values, political transparency and responsibility, state and local autonomy and self-government, the citizen's right to choose his state, not the other way around. Nothing offsets these costs. Cooperative federalism has no public-interest justification. It is an accommodation to interest group demands and to the interests of poorly monitored political actors.

Cooperative federalism is enormously resilient and, moreover, self-stabilizing. The range of conflict within the system is defined by the participant-beneficiaries' fight over the terms of cooperation. State and local governments will complain about unfunded mandates and federal imposition; national interest groups and their congressional patrons will complain about state shirking and non-compliance. Furor over unfunded mandates produces more money and less onerous federal conditions; interest group complaints over the states' failure to use federal block grants for their intended purposes leads to the re-categorization of federal programs.[150] Either way, the system returns to its bargaining equilibrium, typically at a higher level of aggregate spending.

Under ordinary political conditions, cooperative arrangements are virtually immune to political reform. In Germany and in the United States, cooperative federalism came under challenge during periods of serious economic malaise and manifest civic alienation, coupled with exogenous shocks (re-unification and European integration in Germany's case, and the ascent of a determined, ideological administration in the United States). The record strongly suggests that cooperative federalism is impregnable even under those disadvantageous conditions.

While the campaign for a more competitive German federalism is quite probably a lost cause, one can be a bit more opti-

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[150] That has been the historical experience with federal block grants. *See, e.g.*, Timothy J. Conlan, *And the Beat Goes On: Intergovernmental Mandates and Preemption in an Era of Deregulation*, 21 PUBLIUS 44 (1991).

mistic about the prospects of cooperative federalism in the United States. Our federalism, mercifully, is not Europe's—not yet, at any rate. American citizens are more mobile than Europeans, more accustomed to conflict and competition, more distrustful of political centralization and hence less easily herded into stifling cooperative regimes. We have a much larger reservoir of public support, albeit latent support, for a more competitive politics.[151]

Moreover, American cooperative federalism is not a constitutional mandate or arrangement. Rather, it is constitutionally constrained. This circumstance implies somewhat more leeway, compared to constitutionally cooperative countries, for piecemeal political reform. It also implies a possibility of tighter constitutional limitations on cooperative arrangements. I consider these options—under present circumstances—in turn.

A. Political Reform?

Serious federalism reform would have to address the agency problems that lie at the heart of the cooperative federalism problem.[152] Mere attempts to improve transparency—such as executive "federalism impact statements" employed by the Reagan administration—will fail to discipline politicians and to erase the information asymmetries between interest groups and taxpayers.[153] Managerial, administrative reforms will likewise fail to remedy cooperative federalism's dysfunctions, and may make matters worse.

The contemporary political debate shows little awareness of this elementary point. The current Administration's educa-

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[151] For a fuller development of this point and its federalism implications see MICHAEL S. GREVE, REAL FEDERALISM 139-46 (1999).

[152] Zelinsky, *supra* note 109, at 1356-58, 1396-1406.

[153] *Id.* at 1398 ("[E]ven the most expertly prepared cost estimates will not inhibit legislatures from adopting proposed mandates"). Roin, *supra* note 135, at 376-79, criticizes Zelinsky's assumption of rational voter ignorance and insists that local politicians can "educate" voters. The evidence, however, suggests otherwise. Like some Justices, Printz v. United States, 521 U.S. 898, 957-58 (1997) (Stevens, J., dissenting), Roin cites the Unfunded Mandates Reform Act as a splendid example of effective state and local voter education and federalism reform. By near-unanimous consent however, UMRA has been a failure. *See* sources cited *supra* note 87.

tion reform proposals, for example, would consolidate a panoply of federal education programs into a handful of block grants and attempt to increase accountability by conditioning the continued receipt of federal funds on educational results, rather than compliance with funding restrictions.[154] Those reforms, if implemented, will fail. The threatened "consequences" of a funding cut-off would hit school children before hitting local bureaucrats, and, moreover, deprive the federal government of its leverage over non-performing school districts. Since that is the opposite of the intended effects, comparable threats have never materialized on any significant scale in any policy area,[155] and they are not going to materialize in the future. At best, an emphasis on results—and "consequences" in the event of inadequate results,[156]—will be ineffectual. At worst, it will create a moral hazard problem: experienced interest groups and administrators know that the most likely consequence of failure is increased federal funding.[157] "Smart," results-orient-

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[154] President George W. Bush, *No Child Left Behind* http://www.ed.gov (last modified Apr. 9, 2001).

[155] Accounts of the toothlessness of federal cut-off sanctions, especially in the education arena, are legion. JEREMY A. RABKIN, JUDICIAL COMPULSIONS: HOW PUBLIC LAW DISTORTS PUBLIC POLICY 148-58 (1989) (despite massive resistance to school integration and judicial prodding, federal Office for Civil Rights only rarely used funding termination, or threats thereof, to enforce Title VI); NATIONAL COUNCIL ON DISABILITY, BACK TO SCHOOL ON CIVIL RIGHTS: ADVANCING THE FEDERAL COMMITMENT TO LEAVE NO CHILD BEHIND 11 (2000) (even though every state failed to comply with Individuals with Disabilities Education Act, "only one enforcement action involving a sanction (withholding) and five others involving imposition of 'high risk' status and corrective action as a prerequisite to receiving further funds, have been taken. The only withholding action occurred once for a temporary period and was overruled by a federal court.").

[156] "Results," "accountability," and "consequences" enjoy bipartisan support. *See, e.g.*, Andrew Rotherham, *The New Three R's of Education* 15, 18, in 10 BIG IDEAS: A NEW DEMOCRAT AGENDA FOR GOVERNING (Democratic Leadership Council, 2001) (endorsing "performance-based" education reforms with "accountability for results" and "real consequences for performance," without giving hint as to what those consequences might be); David E. Sanger, *The New Administration: The Plan; Bush Pushes Ambitious Education Plan*, N.Y. TIMES, Jan. 24, 2001, at A1 (noting bipartisan support for "accountability" and Mr. Bush's emphasis on "consequences").

[157] That has been the historical experience. *See* Jacques Steinberg, *Adding a Financial Threat to Familiar Promises on Education*, N.Y. TIMES, Jan. 26, 2001, at A17.

ed regulation produces incentives for failure.

One can think of reforms that would reduce agency and monitoring problems. The new Administration's just-criticized education reform proposals, for instance, also include the idea of making certain federal funds "portable," meaning that the money would follow students (presumably, from lousy to better schools or districts).[158] The funds (and citizens) would escape the cooperative tangle (which is precisely why the portability proposals have met with fierce resistance from the education establishment). For another example, modest revisions of the 1996 Welfare Reform Act, which is scheduled for re-authorization in 2002, could provide that states may use unspent federal allocations under the law for general-purpose tax cuts. Existing law and regulations contain a mandatory flypaper effect in the form of "maintenance of effort" requirements and restrictions on the use of federal allocations for general tax relief purposes;[159] abolishing those restrictions should have a marginal disentanglement effect at the state level.[160] More ambitiously, imagine—for any federally funded statute of your choice—a proportional tax rebate for taxpayers in states that decline to participate in the program, thus offsetting some of the incentives that currently push states towards participation. States might become more diverse; competition and exit rights, more powerful. Prospectively, under a generic reimbursement rule, conditional funding programs would become less attractive for federal legislators and state governments.[161]

Precisely because these and similar reforms would reduce agency problems and diminish political rents, however, one cannot readily imagine their enactment. Most certainly, cooperative federalism reform will never emerge from some govern-

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[158] For a discussion of the portability proposal see Chester E. Finn, *Think Portability, Not Vouchers*, THE WEEKLY STANDARD, Jan. 22, 2001.

[159] U.S. Department of Health and Human Services (listing restrictions on use of TANF funds) *at* http://www.act.dhhs.gov/news/welfare/aspesum.htm (last visited Apr. 11, 2001).

[160] Few states would pass the entire amount of federal allotments to taxpayers. *See supra* note 131 and accompanying text.

[161] That is so because citizens' tax "reimbursement" would rise in proportion to any increased financial incentives that Congress might offer to ensure enactment and to induce state participation.

mental affairs subcommittee or a presidential task force to "reinvent government." Rather, much like the New Federalism, it would have to be an intensely partisan, political, constituency-oriented initiative. The Republican leadership would have to recognize, and to act on the insight, that cooperative federalism's principal effect is to expand state and local government and to sustain policy cartels, from teachers unions to environmental advocacy groups, that in turn can mobilize large numbers of clients and supporters. Cooperative federalism's beneficiaries, in other words, are not exactly core Republican constituencies. (In fact, the Republican Party's electoral future may in good part depend on weakening cooperative federalism's clientele.)[162] Moreover, since state and local governments would strenuously oppose any such strategies, aspiring federalism reformers would have to split that constituency.

It may seem odd and dispiriting that federalism reform should collapse into a ruthlessly partisan agenda.[163] Cooperative federalism, however, is all about accommodating distributional coalitions. Hence, reform must be about disabling them. That, in turn, is not going to happen as an incidental by-product of a new and improved intergovernmental organization chart. If it can happen at all, it will happen as the result of a determined political campaign.

B. Constitutional Constraints?

Constitutional constraints on cooperative federalism can emerge from a Supreme Court that is willing and able to reassess dual federalism norms even against the will of distributional coalitions and their legislative patrons. The likelihood of such a scenario is principally an institutional question, not a matter of legal doctrine. The question does, however, have a doctrinal dimension.

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[162] The union vote alone made a substantial difference in the 2000 presidential elections, accounting for Gore victories in several closely contested states. Union Voters in Key States Helped Al Gore Win Popular Vote, *at* http://laborresearch.org/ hatl_elections/turnout_00.htm (last visited apr. 11, 2001).

[163] I have lamented the fact and developed the point at greater length elsewhere. *See* GREVE, *supra* note 151, at 135-40.

In re-establishing (some) federalism norms over the past decade, the Supreme Court has dealt serious setbacks to labor unions, feminist advocacy groups and environmental interest groups.[164] The fact that these decisions have failed to generate a serious political response[165] indicates that the Supreme Court has considerable leeway in pursuing its federalist project. The question is whether and to what extent the Court is willing and able to articulate federalism doctrines that will not simply protect states from federal imposition but will instead, or in addition, shackle federalism's evil cooperative twin. The Court has begun to articulate values of political accountability and responsibility that cut against cooperative arrangements.[166] The difficult task is to translate those values into something resembling a coherent constitutional doctrine.

Such an endeavor would essentially have to start from scratch. An explanation of why the states and the feds cannot cooperate, on terms they see fit, has to start with the recognition that cooperative federalism divorces the politicians' interests from the citizens'—in other words, with agency problems. That recognition failed to inform the judicial consideration of cooperative arrangements even in early, pre-New Deal days. In 1923, the Commonwealth of Massachusetts challenged the so-called Maternity Act, a conditional funding statute that extended partial federal funding to states that agreed to participate in a federal entitlement program. Though nominally voluntary, Massachusetts argued, the Maternity Act left the Commonwealth no choice but to cooperate.[167] While the Supreme

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[164] *See, e.g.*, Solid Waste Ass'n v. United States Army Corps of Eng'rs, 531 U.S. 159, 174 (2001) (ruling that extension of federal wetlands regulations to isolated waters and wetlands would cast constitutional doubt on Clean Water Act); United States v. Morrison, 529 U.S. 598, 627 (2000) (holding core provision of Violence Against Women Act exceeds congressional power under Commerce Clause and Fourteenth Amendment); Alden v. Maine, 527 U.S. 706, 713 (1999) (holding that states enjoy sovereign immunity against damage claims under Fair Labor Standards Act in state court).

[165] *E.g.*, *Morrison*, 529 U.S. at 659-60 (Breyer, J., dissenting) (suggesting several legislative options to re-enact constitutionally permissible version of civil remedies provision invalidated in that case). In re-authorizing the Violence Against Women Act in 2000, Congress failed to pursue those options.

[166] *See infra* notes 188-97 and accompanying text.

[167] Massachusetts v. Mellon, 262 U.S. 447, 478-80 (1923).

Court did not reach the merits of the claim, it showed very little patience with the state's coercion argument. If Congress enacted the Maternity Act with the purpose of tempting states to yield their authority, said the unanimous Court, "that purpose may be effectively frustrated by the simple expedient of not yielding."[168] As for the citizens' averred interests, the Court ruled that neither the Commonwealth nor individual taxpayers had satisfied the constitutional requirements to invoke the Court's jurisdiction.[169]

In *Massachusetts v. Mellon*, the state argued alongside its citizens, against a federal cooperative scheme. Little more than a decade later, it was left to private citizens to carry "the states' rights plea against the states themselves."[170] In 1937, the Supreme Court entertained a constitutional challenge to certain sections of the Social Security Act on the grounds that the tax and conditional funding regime of the Act effectively deprived states of their autonomy, thereby violating the Tenth Amendment. The plaintiff, Steward Machine Company, was a private corporation; the states, by all appearances, joined the federal defendants.[171] The Tenth Amendment? Ain't nobody around but us cooperating state chickens. Justice Cardozo's opinion for the Court duly noted the fact, effusively endorsed congressional efforts to "find a method" by which "public agencies may work together to a common end,"[172] and rejected the Tenth Amendment challenge.[173]

In its embrace of political nostrums over constitutional formalism[174] and its emphasis on the states as the basic unit of the federalism analysis, *Steward Machine Co.* foreshadows the post-New Deal Supreme Court's commitment, later made

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[168] *Mellon*, 262 U.S. at 482.

[169] *Id.* at 488-89.

[170] ROBERT JACKSON, THE STRUGGLE FOR JUDICIAL SUPREMACY 160 (1941).

[171] Charles C. Steward Mach. Co. v. Davis, 301 U.S. 548, 589 (1937).

[172] *Steward Mach. Co.*, 301 U.S. at 588.

[173] *Id.* at 585, 589-98.

[174] Justice Cardozo's ringing endorsement of cooperative federalism rests on the notion that interstate competition would preclude states from enacting unemployment compensation schemes on their own. *Id.* at 587-88. Even Cardozo's tendentious account of the evidence, however, shows that some states had in fact enacted such laws prior to the passage of the federal Social Security Act. *Id.*

explicit, to "process federalism." First propounded by Professor Herbert Wechsler, process federalism maintains that federalism norms are judicially unenforceable because the states enjoy adequate protection in and through the political process.[175] Since that maxim or principle applies even to coercive federal mandates that are opposed by the states,[176] it applies *a fortiori* to cooperative programs to which the states have consented.

Over the past decade, the Supreme Court has explicitly and repeatedly rejected the Wechslerian premise[177] and, to that extent, made room for an assertion of constitutional constraints on cooperative federalism. The Justices have been of two minds, however, about the reasons for rejecting process federalism and about the constitutional values the new, judicial federalism is supposed to serve. At times, the Justices seem preoccupied with protecting the states' autonomy and sovereignty. Process federalism's central error, on this view, is the empirical claim that the states will be able to protect themselves against federal overreach. On other occasions, the Court has rested its federalism decisions on protecting political transparency and responsibility. On this view, process federalism's crucial error is the initial premise that federalism is "about" the rights of the states, as distinct from the citizens' interests. To an extent, the two perspectives are compatible. Contrary to widespread belief, however, including quite probably beliefs held by several Justices, state sovereignty and political responsibility are not entirely congruent. If state politicians are prepared to give the state's autonomous, sovereign consent to cooperative arrangements that undermine responsibility and accountability, the responsibility view will cast constitutional

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[175] Herbert Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 COLUM. L. REV. 543, 543 (1954). Neo-Wechslerian defenses of judicial abdication prominently include JESSE CHOPER, JUDICIAL REVIEW AND THE NATIONAL POLITICAL PROCESS 175-84 (1980); Larry Kramer, *Putting the Politics Back Into the Political Safeguards of Federalism*, 100 COLUM. L. REV. 215 (2000); Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485 (1994).

[176] Garcia v. San Antonio Metro. Transit Auth., 469 U.S. 528, 550-55 (1985).

[177] John C. Yoo, *The Judicial Safeguard of Federalism*, 70 S. CAL. L. REV. 1311, 1314 (1997). The Supreme Court has "essentially overruled the reasoning of *Garcia*." *Id.*

doubt on cooperative federalism arrangements that seem acceptable from a states' rights perspective.

C. States' Rights

The states' rights perspective views each state as a benevolent despot, whose interests are harmonious with its citizens'. (The opposite presumption—for instance, the notion that state politicians might "cooperate" with the national government so as to diffuse and obscure political responsibility—would, from this perspective, reflect a "gross lack of confidence in the electorate that is at war with the basic assumptions underlying any democratic government.")[178] Cooperative arrangements appear essentially unproblematic, provided they are genuinely cooperative. State consent is dispositive, and it can usually be presumed when money changes hands. For instance, when a state consents to accept federal restrictions or to perform regulatory functions in exchange for federal funds, no constitutional problem arises, provided that the state knows *ex ante* what it is getting into and, moreover, that the arrangement violates no independent constitutional constraints.[179] (Obviously, states may not agree to abrogate First Amendment rights in exchange for federal funds.) On the other hand, the Constitution is violated when states are being "commandeered" to administer federal tasks for no consideration and without their consent.[180] The hard constitutional cases are those where federal "encouragement" shades into "coercion."[181]

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[178] Printz v. United States, 521 U.S. 898, 958 n.18 (Stevens, J., dissenting).

[179] South Dakota v. Dole, 483 U.S. 203, 207-08 (1987).

[180] Lack of consideration alone appears to be insufficient to void cooperative arrangements. Conditional preemption statutes, for instance, effectively compel states to regulate or else, surrender their residual regulatory autonomy to the federal government. Still, the Supreme Court has sustained such arrangements. FERC v. Mississippi, 456 U.S. 742, 745 (1982); Hodel v. Va. Surface Mining & Reclamation Ass'n, 452 U.S. 264, 268 (1981).

[181] *See* New York v. United States, 505 U.S. 144, 175 (1992) (holding federal statutory provision unconstitutional because Congress "crossed the line distinguishing encouragement from coercion."); *Dole*, 483 U.S. at 211 (holding that "[o]ur decisions have recognized that in some circumstances the financial inducement offered by Congress might be so coercive as to pass the point at which 'pressure turns into compulsion.'" (quoting Steward Mach. Co. v. Davis, 301 U.S. 548, 590

The states' rights perspective inhibits cooperative federalism to some extent, depending on the stringency of the consent requirement. Robust requirements—for example, the notion that a state's acceptance of federal funds, without more, does not automatically imply consent,[182] or a requirement that conditional funding statutes must evidence a clear congressional intent about the scope and consequences of the state's obligations[183]—will unravel some cooperative arrangements. Prospectively, such rules drive up legislative transaction costs to the point of vitiating some otherwise viable bargains.[184] The same consequences would flow from a stricter judicial requirement of a "reasonable relation" between the purpose of a federal grant program and the regulatory conditions imposed thereunder.[185]

A very strong premise of state autonomy and consent might doom a large number of cooperative schemes. For example, the warped financial incentives that induce reluctant states to accept conditional funding obligations might be said to constitute a subtle form of "coercion." Such a judicial move, however, is neither likely nor plausible: one state's successful complaint about "coercion" would effectively abrogate another state's meaningful consent.[186] The principal and intended ef-

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(1937)).

[182] Atascadero State Hosp. v. Scanlon, 473 U.S. 234, 242 (1985) (holding statute must make "unmistakably clear" that surrender of sovereign immunity is condition of federal grant receipt); *see also* Dellmuth v. Muth, 491 U.S. 223, 232 (1989) (requiring "unequivocal declaration" from Congress in order to exercise powers of abrogation).

[183] *See, e.g.*, Pennhurst State Sch. & Hosp. v. Halderman, 451 U.S. 1, 17 (1981) (noting that "legitimate conditions" means that "state[s must] voluntarily and knowingly" enter into these agreements).

[184] William N. Eskridge, *Overriding Supreme Court Statutory Interpretation Decisions*, 101 YALE L. J. 331, 419 (1991).

[185] It seems clear that some such nexus is required; the unresolved issue is the closeness of the "fit." *Dole*, 483 U.S. at 208; *id.* at 212 (O'Connor, J., dissenting). The Supreme Court has viewed the nexus question as one of "states' rights." *Id.* at 207-08. The nexus requirement, however, is better understood as a question of political transparency and responsibility. *See infra* notes 188-97 and accompanying text.

[186] I assume the desired remedy is an injunction against the operation of the statute, rather than a demand (pursuant to what?) for a reimbursement of the state taxpayers' proportional contribution to the federal regime.

fect of a full-blown states'-rights jurisprudence, then, is not the curtailment of cooperative federalism but rather a strengthening of the states' bargaining position vis-a-vis the federal government.[187]

D. Accountability

In several federalism cases, the Supreme Court has articulated a "dual" federalism perspective. The crucial federalism problem, under this conception, is not the threat of federal coercion of the states but rather excessive, unconstitutional delegation to them.[188] Consent, from this vantage point, is immaterial. Just as Congress may not delegate and eviscerate legislative power (with or without the executive's consent)[189] or unduly enlarge its powers (ditto),[190] so it may not delegate its powers to state and local officials, with or without their consent.[191] If the federal government wishes to coerce private citizens, it must do so directly.[192] Conversely, a state may not surrender its sovereign powers to the national government[193] or agree to an expansion of congressional authority beyond the

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[187] *E.g.*, Hills, *supra* note 10, at 943 (anti-commandeering rules of *New York* and *Printz*).

[188] *Id.* at 843-55 (dual federalism treats federalism as delegation problem).

[189] INS v. Chadha, 462 U.S. 919, 944-59 (1983).

[190] Buckley v. Valeo, 424 U.S. 1, 118-37 (1976).

[191] The "analogy" between federalism and separation-of-powers cases is drawn explicitly in one opinion. New York v. United States, 505 U.S. 144, 182 (1992).

[192] Printz v. United States, 521 U.S. 898, 935 (1997); *New York*, 505 U.S. at 178 (holding that "[w]here a federal interest is sufficiently strong to cause Congress to legislate, it must do so directly; it may not conscript state governments as its agents.").

[193] *See, e.g.*, *In re* Rahrer, 140 U.S. 545, 560 (1891) (noting that if Congress "can adopt a state law as its own, it must be one that it would be competent for it to enact itself, and not a law passed in the exercise of police power") (citing Gunn v. Barry, 82 U.S. (15 Wall.) 610, 623 (1872); United States v. Dewitt, 76 U.S. (9 Wall.) 41, 45 (1869); Cooley v. Port of Wardens, 53 U.S. (12 How.) 299, 304 (1851)). The injunction against the state "delegation" of exclusive police powers is implied in the logic of enumerated powers. For instance, the fact that three dozen states officially endorse the federal regulation of "gender-based" violence does not render such regulation constitutional. *See* United States v. Morrison, 529 U.S. 598, 653 (2000) (Souter, J., dissenting) (noting state attorneys' general endorsement). The majority opinion in Morrison contains neither a mention of the states' position nor a reply to Justice Souter's observation.

confines of the federal legislature's constitutionally limited powers.[194]

Lest it collapse into pointless formalism, a judicial insistence of constitutional forms, both in the horizontal, separation-of-powers dimension and in the vertical, federalism perspective, is most plausibly based on considerations of political transparency and responsibility—in public choice lingo, concerns over agency and monitoring costs. Horizontally, the Lockean injunction that lawmakers must make laws, not another set of lawmakers,[195] flows from the recognition that the delegation of legislative authority invites shirking and a diffusion of responsibility. The vertical delegation of federal authority poses the same dangers. In contrast to the states' rights perspective, then, dual federalism contemplates, and in fact rests on, the danger of agency conflicts on both sides of state-federal bargains. As the Supreme Court observed in a central passage in *Printz v. United States*, invalidating a federal statute requiring the state and local enforcement of federal gun registration requirements:

> By forcing state governments to absorb the financial burden of a federal regulatory program, Members of Congress can take credit for "solving" problems without having to ask their constituents to pay for solutions with higher federal taxes. And *even when the States are not forced to absorb the costs of implementing a federal program*, they are still put in the position of taking the blame for its burdensomeness and for its defects.[196]

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[194] *New York*, 505 U.S. at 182 ("[W]here Congress exceeds its authority relative to the States . . . the departure from the constitutional plan cannot be ratified by the 'consent' of state officials" and "state officials . . . cannot consent to the enlargement of the powers of Congress beyond those enumerated in the Constitution.").

[195] "The legislature cannot transfer the power of making law to any other hands, for it being but a delegated power from the people, they who have it, cannot pass it over to others." JOHN LOCKE, SECOND TREATISE ON GOVERNMENT 87 (Richard H. Cox ed., 1982).

[196] *Printz*, 521 U.S. at 930 (emphasis added); *see New York*, 505 U.S. at 168-69, 182-83 (1992) (giving *fons et origo* of "accountability" paradigm).

While alluding to the states' rights problem of federal coercion, the Court is principally concerned with a Congress that takes the credit and passes the blame, thus perpetrating political fraud on the voters. The italicized clause strongly suggests that even full compensation for regulatory services rendered might not remedy the constitutional problem. Nor would the state's consent change the analysis. In Roderick M. Hills' terminology, the states' *Printz* entitlement is inalienable.[197] It cannot be surrendered for payment.

E. Schizophrenia

To date, the Supreme Court's federalist majority has refrained from committing itself to either states' rights or the accountability perspective. More precisely, the Court has tended to mobilize considerations of responsibility and accountability in an effort to buttress "states' rights" arguments without noticing, or at least without acknowledging, that the two lines of argument generate disparate results.[198]

The difficulty is most readily apparent in *New York v. United States* and *Printz v. United States*, the Supreme Court's anti-"commandeering" cases. Justice O'Connor's opinion for the *New York* Court first avers that conditional spending and preemption statutes pass constitutional muster because and by virtue of the states' consent.[199] Later in the opinion, however, one learns that a state's consent to be "commandeered" by the federal government does not render the command constitutional, since it would transfer to the Congress a power—"commandeering"—that it does *not* possess under its enumerated powers.[200] The reason—in fact, the only reason—for this nondelegation rule is the agency and accountability argument: "[P]owerful incentives might lead both federal and state offi-

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[197] Hills, *supra* note 10, at 829.

[198] For a similar argument, see generally William P. Marshall & Jason S. Cowart, *State Immunity, Political Accountability, and* Alden v. Maine, 75 NOTRE DAME L. REV. 1069 (2000) (noting that political accountability argument in *Alden* supports sovereign immunity holding but cannot fully explain it).

[199] *New York*, 505 U.S. at 168.

[200] *Id.* at 182.

cials to view departures from the federal structure in their personals interests."[201]

Put aside the question whether the anti-delegation rule is consistent with the states' rights view (or, for that matter, internally coherent): why should those "powerful incentives" operate exclusively, or especially, in "commandeering" situations? The answer seems to be that cooperative programs leave the states a choice, whereas commandeering statutes (by definition) do not.[202] That observation is true—but trivially so, and in any event beside the point. The agency problem—by the lights of *New York*, the constitutional problem—lies in intergovernmental collusion and the attendant divorce of (state and federal) politicians' interests from the citizens' interests. That danger is more pronounced, not less, when the states' participation is induced rather than coerced. At the limit, mutual consent among government actors should create, rather than dispel, a presumption of unconstitutionality.[203]

That thought, while missing from *New York*,[204] is sufficiently obvious to have occurred to participants and spectators on both sides of the federalism divide. In *Printz*, the dissenters observed that the majority's "structural" arguments for extend-

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[201] *Id.*

[202] *Id.* at 168 (noting that "[w]here Congress encourages state regulation rather than compelling it, state governments remain responsive to the local electorate's preferences; state officials remain accountable to the people.").

[203] For a powerful argument along these lines, see generally Ilya Somin, *Closing the Pandora's Box of Federalism: The Case for Judicial Restriction of Federal Subsidies to State Governments*, 90 GEO. L.J. (forthcoming Jan. 2002).

[204] It is also missing from the law review articles *New York* cites in support of its accountability argument. *New York*, 505 U.S. at 169 (citing D. Bruce La Pierre, *Political Accountability in the National Political Process-The Alternative to Judicial Review of Federalism Issues*, 80 NW. U. L. REV. 577 (1985); Deborah Jones Merritt, *The Guarantee Clause and State Autonomy: Federalism for a Third Century*, 88 COLUM. L. REV. 1 (1988)). Both authors vehemently criticize nominally "voluntary" cooperative programs. *See* La Pierre, *supra*, at 594-95 (arguing that "[t]he notion that state participation in national spending programs is voluntary is nothing more than a legal fiction."); Merritt, *supra*, at 17 ("If the purpose of one governmental body is to check another . . . it is foolish to allow the two bodies to conspire together to abandon that check"). Both authors, however, proceed to endorse, substantially without explanation, conditional funding programs as consistent with political accountability. La Pierre, *supra*, at 648 n.378; Merritt, *supra*, at 46-47.

ing the anti-commandeering rule of *New York* apply with equal force to conditional spending and preemption statutes.[205] Justice Scalia's majority opinion at one point concedes the argument (and appears to invite a constitutional challenge to an appropriate statute);[206] at another point, in a slightly different context, the opinion contests the dissenters' argument, with less-than-full conviction.[207] Legal scholars appear to agree that a consistent application of the "dual federalism" on display in *Printz* will render at least some conditional spending statutes unconstitutional.[208]

Outside the commandeering context, the Supreme Court has likewise tended to tie considerations of responsibility and transparency to federal "coercion" or intrusion upon state prerogatives, with equal implausibility. For instance, Justice Kennedy's concurrence in *United States v. Lopez*,[209] an enumerated powers rather than a commandeering case, avers that "the boundaries between the spheres of federal and state authority would blur and political responsibility would become illusory" if the federal government were to "take over the regu-

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[205] Printz v. United States, 521 U.S. 898, 960-61 (1997) (Stevens, J., dissenting).

[206] *Id.* at 917-18. The Court noted, in discussing conditional funding statutes and federal statutes requiring states to provide information to the federal government, that "[w]e of course do not address these or other currently operative enactments that are not before us; *it will be time enough to do so if and when their validity is challenged* in a proper case." *Id.* at 918 (emphasis added).

[207] *Id.* at 923 n.12 ("The dissent is correct . . . that control by the unitary Federal Executive is also sacrificed when States voluntarily administer federal programs, but the condition of voluntary state participation significantly reduces the ability of Congress to use this device as a means of reducing the power of the Presidency."). The assertion is empirically doubtful and, in making a constitutional point turn on a matter-of-degree, stands in jarring contrast to the ostentatiously formalistic tenor and holding of *Printz*.

[208] *See, e.g.*, Evan H. Caminker, Printz, *State Sovereignty, and the Limits of Formalism*, 1997 SUP. CT. REV. 199, 230-31 (noting that "[a]rguably, the requirement of presidential supervision should run to *all* forms of state administration of federal programs"); Hills, *supra* note 10, at 826 (noting that accountability "argument seems to condemn not merely federal laws that commandeer state or local services but also even *voluntary* intergovernmental cooperation"); Vicki C. Jackson, *Federalism and the Uses and Limits of Law:* Printz *and Principle?*, 111 HARV. L. REV. 2180, 2201-05 (1998) (noting difficulty of connecting accountability argument with anti-commandeering rule).

[209] 514 U.S. 549 (1995).

lation of entire areas of traditional state concern."[210] Obviously, however, wholesale federal preemption and enforcement present a lesser danger of "blurring" than some cooperative schemes. Similarly, the Supreme Court has tended to view the (more or less stringent) requirement of a nexus between a federal grant and its accompanying conditions as a question of states' rights.[211] States' rights, however, provide no reason to believe that federal funding in exchange for compliance with an unrelated regulatory regime should be any more coercive than a closely matched *quid pro quo*. The degree of "coerciveness" should correspond to the amount of funding and the stringency of the requirements, not to any nexus or lack thereof. The most plausible functional reason for a nexus requirement is to enable citizens to determine whether the state's regulatory impositions, pursuant to a federal statute, are worth the federal dime.[212] That difficulty is considerable even when the cash nexus is direct, since state and federal politicians will in any event blame each other. It is further exacerbated when the politicians swap suitcases of cash in a back alley at the other end of the cooperative megalopolis.

Both the Supreme Court's states' rights jurisprudence and the confinement of agency and accountability arguments to that context have reached the outer limits of their plausibility.[213] Instead of straining the arguments any further, it would be far better to rest federalism squarely on the constitutional values

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[210] *Lopez*, 514 U.S. at 577 (Kennedy, J., concurring).

[211] *See, e.g.*, South Dakota v. Dole, 483 U.S. 203, 210-11 (1987).

[212] The most compelling textual reason for the requirement is that the Constitution authorizes Congress to spend for the general welfare, not to regulate towards that end. U.S. CONST. art. I, § 8, cl. 1. The difference, however, while intuitively appealing, is hard to articulate. The Supreme Court has found "an obvious difference between a statute stating the conditions upon which moneys shall be expended and one effective only upon assumption of a contractual obligation to submit to a regulation which otherwise could not be enforced." United States v. Butler, 297 U.S. 1, 73 (1936). But the Court did not explain that "obvious" difference in *Butler*, and has failed to do so since.

[213] *See, e.g.*, Michael B. Rappaport, *Reconciling Textualism and Federalism: The Proper Textual Basis of the Supreme Court's Tenth and Eleventh Amendment Decisions*, 93 NW. U. L. REV. 819, 821 (1999) (arguing that Supreme Court's rulings on "commandeering" and sovereign immunity cannot be based on Tenth or Eleventh Amendment); *supra* notes 188-97 and accompanying text.

of political responsibility accountability and transparency.

The problem with such an approach lies not in connecting federalism to the substantive values of political responsibility and transparency. One would be hard pressed to deny either the constitutional salience of those values or their connection to the federalist architecture.[214] To be sure, a federalist system is messier (and, in that sense, less "transparent") and diffuses responsibility to a greater extent than a wholly unified system. So long as "diffusion" means competition (as opposed to collusion), however, it will tend to enhance transparency and responsibility—much like competition in private markets generates information that, in a monopolistic or cartellized market, would never see the light of day. Nor, to my mind, is there a particular problem with the notion that a massive failure of the political process to protect core constitutional concerns provides a presumption for the judicial enforcement of those values. The idea that the intensity of judicial review should be inversely proportional to the political process protection of constitutional structures and concerns has been a bedrock principle of modern constitutional law, from the judiciary's heightened concern for "discrete and insular minorities"[215] to, well, the Wechslerian idea that the Supreme Court should stay its hand in federalism cases because the states would be able to protect themselves.[216] Regardless of what one makes of a process justification in general or of this or that particular version, the idea that judicial review should in some fashion correspond to struc-

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[214] In point of cute fact, Madison appears to have coined the word "responsibility." Douglass Adair, *The Federalist Papers*, *in* FAME AND THE FOUNDING FATHERS: ESSAYS BY DOUGLASS ADAIR 257 n.8 (Trevor Colbourn ed., 1974). "Responsibility," Madison wrote, "in order to be reasonable, must be limited to objects within the power of the responsible party, and in order to be effectual, must relate to operations of that power, of which a ready and proper judgment can be formed by the constituents." THE FEDERALIST No. 63, at 383 (Clinton Rossiter ed., 1961). While the quote—which reads like a one-sentence indictment of cooperative arrangements—appears in a limited context (the size and composition of the Senate), it reflects Madison's broader views on the subject. DAVID F. EPSTEIN, THE POLITICAL THEORY OF THE FEDERALIST 179-82 (1984).

[215] Carolene Prods. v. United States, 304 U.S. 144, 152 n.4 (1938).

[216] *See* Hills, *supra* note 10, at 821 ("'[P]olitical process' theories of constitutional federalism are not really theories of federalism at all but theories of judicial review . . . .").

tural political failures is one of the few small patches of common ground in the federalism debate.[217] If federalism's point is the citizens' liberty, rather than state sovereignty; if the federalism problem is not federal coercion but federal-state collusion; if cooperative federalism "threatens the very liberty and accountability that federalism is intended to protect"[218]—then the citizens' lack of effective political protection against intragovernmental collusion provides a warrant for judicial interventions that protect and preserve the values and interests that are being conspired against.

The problem lies in operationalizing coherent judicial doctrines about—or against—cooperative federalism that reflect the constitutional text and structure, not disembodied values. That is a vast, difficult, and with the exception of a few intriguing law review articles on the scope of the Spending Clause,[219] unexplored terrain. It cannot be right that the Constitution forbids *all* cooperative arrangements (except those explicitly provided for in the Constitution itself).[220] States must be able to consent to some arrangements with sister-states or the national government; that is part of what it means to be a state.[221] On the other hand, the constitutional structure arguably warrants some restraints on cooperation.

The case law and the literature suggest the rough contours

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[217] *New York* and *Printz* rest explicitly on a political process failure. *See supra* note 198 and accompanying text. Amazingly, so does *Garcia*, the quintessential "process federalism" decision. *See* Garcia v. San Antonio Metro Transit Auth., 469 U.S. 528, 554 (1985) (holding that judicially enforced limitations on Commerce Clause should "be tailored to compensate for possible failings in the national political process.").

[218] Gordon, *supra* note 71, at 212.

[219] *See, e.g.*, Lynn A. Baker, *Conditional Spending After* Lopez, 95 COLUM. L. REV. 1911 (1995).

[220] *But see* Somin, *supra* note 203 (arguing that in principle, all federal grants to states are unconstitutional).

[221] Rappaport, *supra* note 213. Rappaport argues forcefully that state immunities are better grounded in the original meaning of the term "state" than in the Tenth or Eleventh Amendment. *Id.* at 821. His approach suggests a "strong argument" for an ancillary state immunity "that would prevent Congress from using its spending power to pressure the states either to comply with federal regulations or to enforce federal laws." *Id.* at 853 n.111. Presumably, though, Rappaport would agree that an ability to consent to agreements with other sovereigns is a hallmark of sovereign state power.

of accountability-based doctrines that would accomplish that result. An uncompromising, bilateral injunction against vertical delegation is one such doctrine: the federal government may not confer upon the states an authority to exercise inherently federal powers, with or without the states' consent.[222] An analogy to horizontal separation of powers cases further suggests that a completely standardless vertical delegation ("take the money, and do as you wish") would likewise pose constitutional problems.[223] Conversely, the states may not surrender their own sovereign authority to the national government or authorize, by consent or otherwise, the exercise of federal authority beyond the realm of enumerated, limited powers.[224] Doctrines requiring the states' explicit consent to federal conditions would be strengthened, and doctrines requiring a "reasonable relation" between grants and conditions would be tightened—[225] not because the states need the protection, but because citizens would benefit from knowing that their state politicians walked into the federal scheme with eyes wide open.

To date, the Justices have pursued their federalist project in a piecemeal fashion and with an eye towards avoiding a head-on confrontation with the Congress and its constituencies.[226] A gradual move toward a citizen-centered, dual feder-

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[222] For example, a statute delegating treaty-making powers to the states would quite obviously be unconstitutional. The question of whether Congress may authorize the states to regulate interstate commerce—even when such regulation, in the absence of congressional authorization, would run afoul of dormant Commerce Clause—is much trickier. The modern (post-New Deal) Court's position seems to be that Congress may authorize such state regulation, provided that it expresses its "unambiguous intent" to that effect. New York v. United States, 505 U.S. 144, 171 (1992) (citing Wyoming v. Oklahoma, 502 U.S. 437, 458 (1992); Prudential Ins. Co. v. Benhamin, 328 U.S. 408, 427-31 (1946)). The complications, however, have to do with the concurrent (rather than exclusive) nature of the power, not with the delegation principle. *See generally* LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW 1242-45. (3d ed. 2000).

[223] *See* Joshua D. Sarnoff, *Cooperative Federalism, the Delegation of Federal Power, and the Constitution*, 39 ARIZ. L. REV. 205, 211 (1997) (arguing that overly broad congressional delegations of regulatory authority to states are unconstitutional).

[224] *New York*, 505 U.S. at 182.

[225] For a proposal to this effect see Baker, *supra* note 219.

[226] GREVE, *supra* note 151, at 80-82.

alism is broadly consistent with that strategy, since it would leave ample room for cooperative political mischief. Cooperative federalism's constitutional future thus depends largely on the Justices' willingness to pursue the constitutional logic that ties federalism to the principles of political responsibility and transparency—without tripping over their states' rights feet.

VII. CONCLUSION

Cooperative federalism's political economy appears to dictate ever-more entrenchment and entanglement. Political reforms require extraordinary circumstances, and are bound to fail even then. While the Supreme Court may be able to curb cooperative arrangements, it cannot on its own, and against the will of entrenched political coalitions, re-create Justice Sutherland's Constitution. It learned that lesson in 1937, and it needs no reminders from Justice Souter to remember it today.[227] The prevailing trend is towards further centralization with a human (green, diverse) face nationally, and even internationally. It seems virtually impossible to imagine a more competitive politics and Constitution.

That analysis suggests, though, that a decade or two hence, America will look a whole lot more like Germany—entangled, paralyzed, demoralized. The active pursuit of that option is being urged by learned scholars on and off the Bench, who have persuaded themselves that America's constitutional federalism is, if not a big historical mistake, at least unsuited to the realities of the administrative state.[228] A march into constitutionalized cooperation, however, to say nothing of a return to the Articles of Confederation,[229] is as

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[227] The allusion is to Justice Souter's hyperbolic dissents in *Lopez* and *Morrison*. United States v. Lopez, 514 U.S. 549, 603-15 (1995) (Souter, J., dissenting); United States v. Morrison, 529 U.S. 598, 641-42, 651 n.19 (2000) (Souter, J., dissenting) (lamenting "near tragedy" ensuing from judicial efforts to enforce Commerce Clause limitations).

[228] *See generally* Printz v. United States, 521 U.S. 898, 976-77 (1997) (Breyer, J., dissenting); Hills, *supra* note 10.

[229] For an odd paean to the German Constitution and the Articles of Confederation as embodiments of the "administrative federalism" we should emulate, see Hills, *supra* note 10, at 942-44.

hard to imagine as competitive federalism's full-blown revival. We are not that kind of a people nor is this that kind of a country.

Perhaps, the difficulty in imagining either scenario has to do with the fact that federalist regimes are never purely competitive or cooperative. Even in its competitive heyday, American federalism contained some cooperative policies.[230] At the other extreme, modern Germany's cooperative efforts have failed to suppress all traces of locational competition. Within each country, moreover, the degree of competition varies across policy sectors. If that is so, the search for a general theory of the conditions under which competitive federalism (at a constitutional or regime level) might be preserved or restored should be preceded, or perhaps be complemented, with an attempt to better understand the stability, or lack thereof, of competitive policy arrangements.[231] Even that more modest undertaking, however, is a subject for another day.

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[230] *See* Elazar, *supra* note 63.

[231] For an intriguing effort along these lines, see generally Jonathan R. Macey, *Federal Deference to Local Regulators and the Economic Theory of Regulation: Toward a Public Choice Theory of Federalism*, 76 VA. L. REV. 265 (1990).

POST-PRODUCTION CHARGES TO ROYALTY INTERESTS: WHAT DOES THE CONTRACT SAY AND WHEN IS IT IGNORED?

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I. INTRODUCTION

The headlines of the December 20, 2000 issue of the Mobile (Alabama) Register read as follows:

> Jury orders Exxon to pay state $3.5 billion
> World's largest oil company to appeal finding that it underpaid offshore natural gas royalties to Alabama[1]

The Montgomery, Alabama circuit court jury actually awarded the state of Alabama $71 million in royalty owed but not paid since 1994, $16.7 million in interest, and $3.42 *billion* ($3,420,000,000) in *punitive damages*.[2] The major issue in the case was whether Exxon was entitled to not pay royalty on approximately 10 MMcf of gas per day produced in Alabama state waters but used as lease fuel to compress and transport sour gas, also produced from state waters, to the Exxon onshore processing plant in Mobile.[3] The punitive damage award was made after the introduction into evidence of a number of Exxon internal documents which arguably warned the company it was wrongly calculating the royalty and one memo suggesting that Exxon might get away with the deduction because the Alabama regulators were "inexperienced."[4]

This jury verdict should be a wake-up call to oil and gas lawyers who may be called on to advise operators and lessees about how to calculate lease royalties. Because of the inherent vagueness of the standard gas royalty provision and the dramatic changes in the production marketplace, the last two decades have been filled with litigation in virtually every oil and gas producing jurisdiction on the issue of exactly what does

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[1] MOBILE REGISTER, Dec. 20, 2000, at 1.

[2] *Id.* The punitive damages were apparently based on Exxon's share of three years of production from Bon Secour Bay Field.

[3] *Id.* at 2.

[4] *Id.* The trial court denied Exxon's motions for new trial and remittitur on May 3, 2001 and the case is now on appeal.

the oil and gas lessee owe to the oil and gas lessor under the gas royalty provision.

This article is designed to provide some reading after the wake up. It presents a general overview of the core issues and terms of art, as well as a review, by operation or type, of what, when and where post-production costs can be deductible from gas royalties. This article will also highlight the recent articles and cases on the subject.[5] Although this subject is not a new one, the jurisprudence and commentators are so diverse that there continues to be new developments and trends worthy of periodic review.

II. DEFINING THE CONCEPTS

A. The Typical Lease Royalty[6]

Oil and gas lease royalty clauses usually contain separate provisions for oil and gas.[7] Oil royalty clauses commonly provide for royalty in kind and present relatively few interpretive difficulties. Typical royalty on oil "produced and saved" is a fractional share of that oil "to be delivered at the wells or to the credit of lessor into the pipeline to which the wells may be connected." On the other hand, gas royalty provisions require the payment of money. The determination of the amount is dependent upon whether or not the gas produced is sold or used "off premises." If the gas is sold "on premises," the royalty is generally a fractional share of the "amount realized" or "proceeds" received by the lessee for the gas so sold. If the gas is "sold or used off premises," the royalty is a fractional share of the "market value" or "market price," computed at the well. Notably, oil or gas that is "used" on premises carries no royalty obligations.[8]

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[5] The authors gratefully acknowledge the scholarly work done by previous commentators in the articles cited herein; in particular, Professor Owen L. Anderson for his five separate articles on this subject over the last six years.

[6] This article will not attempt to address issues unique to federal lands or the Outer Continental Shelf (OCS) leases regulated by the Bureau of Land Management (BLM).

[7] *See, e.g.,* AAPL Form 675, Oil and Gas Lease, Texas Form. This language is also used in the various "Producers 88" lease forms commonly found in Mississippi, Alabama and Florida. *See infra* note 8.

[8] Many lease forms also separately express that the Lessee shall have free

Professor Owen L. Anderson has concluded that oil and gas jurisdictions have approached royalty obligations from two different perspectives: as a property right and a contractual right.[9] Professor John S. Lowe has suggested that, although there are indeed two perspectives that various jurisdictions have taken, those perspectives relate to contract interpretation, *i.e.*, whether or not the jurisdiction will consider gas royalty obligations to be (1) unambiguous and controlled by the "plain terms" of the contract or (2) ambiguous and to be interpreted in light of industry customs, implied covenants, and the inherent nature of the lessor/lessee relationship.[10] A brief discussion of these conceptual perspectives is important in evaluating the deductibility of post-production expenses, especially by operation.[11]

1. As a Property Right: A Hard Line

A commonly used definition of royalty, in the oil and gas context, is "a share of [oil and gas] production, free of expenses of production."[12] The property approach to this definition is a share of produced minerals, in its natural state, after the mineral has been brought to the surface by the lessee.[13] In Texas, Mississippi and other states, the lessee acquires a "fee simple determinable estate in the working interest oil in place beneath the property."[14] In Oklahoma and other states, "the lessee most often would acquire a *profit a' prendre*, i.e., the exclusive right to explore and produce any oil that may lie beneath the

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use of oil and gas produced from the lands for operations under the lease. *See, e.g.*, Producers Form 88 (9/70) with Pooling Provision (Hederman Bros. Jackson, MS) (for use in Mississippi Alabama and Florida).

[9] Owen L. Anderson, *Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically? (Part 1)* 37 NAT. RESOURCES J. 547, 571-73 (1997).

[10] John S. Lowe, *Defining the Royalty Obligation,* 49 SMU L. REV. 223, 230-32 (1996).

[11] *See infra* Section IV.

[12] 8 HOWARD R. WILLIAMS & CHARLES J. MEYERS, MANUAL OF OIL AND GAS TERMS 946 (1999).

[13] Anderson, *supra* note 9, at 572.

[14] *Id.*

property, for the duration of a determinable fee."[15] A basic issue is when, or at what point, in the production stream is the lessor entitled to claim its royalty on the oil and gas.[16] "The 'property' answer is: The lessor is entitled to claim the royalty share when the oil [or gas] is captured at the wellhead, i.e., the point at which the oil [or gas] itself is converted from real into personal property."[17] This property law approach to defining the royalty obligation is exemplified by the early Louisiana Supreme Court decision of *Wall v. United Gas Public Service Co.*:[18]

> The reason why the division and delivery is made at the well, in cases where there is to be a division in kind, is that there is where the parties come into ownership of the commodity, there is where title vests. . . . and while there is to be no division of the gas in kind, it is nevertheless contemplated that there shall be a "division," not of the gas in kind but of its *value* as fixed by the market price.
>
> Now if the division in kind, where such is contemplated, should be made at the place where ownership vests, it follows that the division of the value or proceeds of the gas should be made there, provided, of course, that the value of the gas can be determined, and that depends upon whether there is a "market price" for it in the field.[19]

Texas and Mississippi have also followed this "at the well" reasoning, holding that production and the royalty obligation occur simultaneously—at the time and place of the physical severance of oil or gas production from the ground.[20] Courts which follow this property concept also separate the royalty obligation from a lessee's previous marketing commitments or the general customs of marketing natural gas. These jurisdic-

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[15] *Id.*; *see, e.g.*, Frost v. Gulf Oil Corp., 119 So. 2d 759 (Miss. 1960).

[16] Anderson, *supra* note 9, at 572.

[17] *Id.*

[18] 152 So. 2d 561 (La. 1934).

[19] *Wall*, 152 So. at 563.

[20] *See, e.g.*, Piney Woods Country Life Sch. v. Shell Oil Co., 726 F.2d 225 (5th Cir. 1984) (applying Mississippi law); Tex. Oil & Gas Corp. v. Vela, 429 S.W.2d 866 (Tex. 1968).

tions also recognize that the time and place of the royalty measurement and obligation can be altered by contract. However, such alteration must be unambiguously clear.[21]

2. As a Contractual Right: The Interpretive Quagmire

Professor Anderson argues that, historically, royalty is a contractual entitlement dependent entirely upon the language of the governing ordinance, decree or contract.[22] He further advocates that, historically, royalty was a share of the mined product due to the sovereign and that, traditionally, the share was due free of expense once the product was made marketable.[23] Professor Lowe acknowledges the history and property aspects of royalty but advocates that the two camps of oil and gas jurisdictions have emerged because of a fundamental difference in the interpretive principles used to discover the intent of the parties under the royalty obligation.[24] He divides these two camps into "plain term jurisdictions" and "cooperative venture jurisdictions."[25]

Within the plain terms jurisdictions, the courts look at the traditional royalty clause as unambiguous, with plain terms that should be given their usual meaning without resort to any extrinsic evidence of intent.[26] *Texas Oil & Gas Corp. v. Vela*[27]

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[21] See *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d 118 (Tex. 1996), where a sharply divided court held that the addition of the phrase "provided, however that there shall be no deductions from the value of the lessors' royalty by reason of any required processing . . . compression . . . ." to the form royalty clause was an attempt to "merely restate existing law" and did not prohibit deduction of post-production expenses for gas sold off lease. *NationsBank*, 939 S.W.2d at 122.

[22] Anderson, *supra* note 9, at 573.

[23] *Id.* at 583. However, if one looks at royalty as a contractual arrangement, one must question the relevance of this general history since the professed goal of every court interpreting a contract has been to discern the intent of the parties to the contract, not the historical evolution of that contractual concept.

[24] Lowe, *supra* note 10, at 244.

[25] *Id.* at 244, 251. The term "cooperative venture" was first used by Professor Thomas A. Harrell in his article, *Developments in Non-regulatory Oil and Gas Law and Taxation,* 30 INST. ON OIL & GAS L. & TAX'N 311 (1979), and adopted by the Louisiana Supreme Court in *Henry v. Ballard & Cordell Corp.*, 418 So. 2d 1334 (La. 1982).

[26] Lowe, *supra* note 10, at 233. Professor Lowe includes Texas, Kansas, Montana, North Dakota, Mississippi and West Virginia in this group of jurisdictions.

is generally recognized as the seminal case for the literal interpretation of royalty obligations.[28]

> [The parties to the lease] might have agreed that the royalty on gas produced from a gas well would be a fractional part of the amount realized by the lessee from its sale. Instead of doing so, however, they stipulated *in plain terms* that the lessee would pay one-eighth of the market price at the well of all gas sold or used off the premises. This clearly means the prevailing market price at the time of the sale or use.[29]

On the other hand the "cooperative venture jurisdictions" conclude that the royalty provision is ambiguous and that extrinsic evidence concerning the relationship of the parties, the customs of the industry at the time of the lease, the implied covenants of the leases, and fundamental fairness should all be considered.[30] Thus, market value or market price in the royalty provision should be construed in the context of the gas market and whether or not the lessee has entered into a sales contract which complies with its marketing obligation to the lessor and is fundamentally fair to both parties.[31] The leading case in this line of reasoning is *Tara Petroleum Corp. v. Hughey*.[32] In *Tara*, the Oklahoma Supreme Court relied on the "well-known reality of the business" that the lessee has an implied covenant to market, the fundamental and fairness to producers of royalties based on a price higher than the contract price and "the intent and understanding" of the parties to the lease.[33] The court concluded that "the ambiguity should be re-

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Id. These authors would probably include Michigan and New Mexico as late additions.

[27] 429 S.W.2d 866 (Tex. 1968). See *W. T. Carter & Bro. v. Oryx Energy Co.*, 5 S.W.3d 704 (Tex. App. 1999), for a great example of an argument over the meaning of "with a third party." The appellate court used a "plain terms" analysis with disastrous results for the lessee. *Oryx*, 5 S.W.3d at 708.

[28] Lowe, *supra* note 10, at 233.

[29] *Vela*, 428 S.W.2d at 871 (emphasis added).

[30] Lowe, *supra* note 10, at 234. Professor Lowe labels Oklahoma, Arkansas and Louisiana in this category of jurisdictions. *Id.* at 254 n.208. Kansas may also now be in this group.

[31] *Id.* at 234.

[32] 630 P.2d 1269 (Okla. 1981).

[33] *Tara*, 630 P.2d at 1274 (quoting 3A W. SUMMERS, OIL AND GAS § 589 (2d

solved in favor of the lessee as a matter of law, with inquiry restricted to whether the sale was a reasonable contract when made."[34]

3. *Royalty Terms of Art*

Certain words or phrases continuously come up in the standard provisions that have, through litigation, developed into terms of art. For purposes of this discussion those terms are divided into terms of quantity and terms of location.

a. *Terms of Quantity*

- Amount realized
- Proceeds
- Market price
- Market value

These terms all deal with the attempt to measure the *quantity* of the royalty share of production. While advocating that they should all be treated as synonyms, Professor Anderson acknowledges that courts treat them differently.[35]

AMOUNT REALIZED AND/OR PROCEEDS

An early Texas case has noted that the term "proceeds" is defined in Webster as "the amount realized from the sale of property."[36] Indeed, standard form lease provisions appear to use the terms "amount realized" and "proceeds" interchangeably when referring to the royalty obligation for gas sold at the

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ed. W. Flittie Supp. 1980)).

[34] *Id.* (quoting 3A W. SUMMERS, OIL & GAS § 589 (2d ed. W. Flittie Supp. 1980)).

[35] Owen L. Anderson, *Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically? (Part 2)*, 37 NAT. RESOURCES J. 611, 613-14 (1997).

[36] Upham v. Ladd, 95 S.W.2d 365, 366 (Tex. Comm'n App. 1936).

well.[37] However, in *Frey v. Amoco Production Co.*,[38] the Louisiana Supreme Court implied a difference between "proceeds" and "amounts realized" in determining that a royalty provision requiring payment of the amount realized includes more than just proceeds.[39]

> We interpret the "amount realized" by Amoco from the sale of gas to Columbia to encompass both: (1) the *total* price paid by Columbia for the natural gas delivered and (2) the "economic benefits" derived from the lessee's right to develop and explore, a right conferred by the lease.[40]

Six years later, in distinguishing *Frey*, the Oklahoma Supreme Court noted that the leases the court was construing required royalty payments based on "gross proceeds received on the sale [of production] at the mouth of the well" as opposed to "amounts realized."[41]

Courts have also indicated a clear sensitivity to "gross (total) proceeds" versus "net proceeds," especially with respect to the deductibility of cost from the royalty obligations.[42] "Proceeds" in a form lease royalty provision, without any adjective, has been held to mean "gross proceeds."[43]

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[37] In *Piney Woods Country Life Sch. v. Shell Oil Co.*, 726 F.2d 255 (5th Cir. 1984) (applying Mississippi law), the Fifth Circuit used the terms "proceeds" and "amount realized" interchangeably in discussing the difference between the royalty measurement under the various provisions at issue. *Piney Woods*, 726 F.2d at 233-38.

[38] 603 So. 2d 166 (La. 1992).

[39] *Frey*, 603 So. 2d at 180.

[40] *Id.* at 179-80. This expansive construction of the term "amount realized" was a primary basis for the lower court in determining that lessors were entitled to a royalty share of take-or-pay settlements entered into by lessee with a third party pipeline. *Id.* at 169.

[41] Roye Realty & Developing, Inc. v. Watson, 949 P.2d 1208, 1213 (Okla. 1996).

[42] See, for example, *Judice v. Mewbourne Oil Co.*, 939 S.W.2d 133, 136 (Tex. 1996), and cases cited therein.

[43] *See* Hanna Oil & Gas Co. v. Taylor, 759 S.W.2d 563, 565 (Ark. 1988) (holding form lease to be construed against lessee, who could have inserted "net" had it intended to deduct costs); West v. Alpar Res., Inc., 298 N.W.2d 484, 491 (N.D. 1980) (finding lease to be ambiguous, and thus construed against lessee when language of royalty clause stated lessor was entitled to "one-eighth of the pro-

Regardless of the apparent distinction now being made between amounts realized and proceeds, the courts are very clear that those two terms have had, since 1968, distinctly different meanings from "market price" or "market value" in the context of oil and gas royalty provisions.

> It is clear then that the parties knew how to and did provide for royalties payable in kind, based upon market price or market value, and based upon the proceeds derived by the lessee from the sale of gas. They might have agreed that the royalty on gas produced from a gas well would be a fractional part of the amount realized by the lessee from its sale. Instead of doing so, however, they stipulated in plain terms that the lessee would pay one-eighth of the market price at the well of all gas sold or used off the premises. This clearly means the prevailing market price at the time of the sale or use . . . . We agree with the Court of Civil Appeals, therefore, that the contract price for which the gas was sold by the lessee is not necessarily the market price within the meaning of the lease.[44]

MARKET PRICE AND/OR MARKET VALUE

Market value is defined as the price property would bring when it is offered for sale by one who desires, but is not obligated to sell, and is bought by one who is under no necessity of buying it.[45] Although market price and market value are often used interchangeably, the following distinction has been made between those two terms.

> Market price is the price that is *actually* paid by buyers for the same commodity in the same market. It is not necessarily the same as "market value" or "fair market value" or "reasonable worth." Price can only be proved by actual transactions. Value or worth, which is often resorted to when there is no

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ceeds from the sale of gas" with no mention of deduction for cost of extraction of hydrogen sulphide).

[44] Tex. Oil & Gas Corp. v. Vela, 429 S.W.2d 866, 871 (Tex. 1968).

[45] Exxon Corp. v. Middleton, 613 S.W.2d 240, 246 (Tex. 1981).

> market price provable, may be a matter of opinion. There may be wide differences between them.[46]

The Arkansas Supreme Court, in *Clear Creek Oil & Gas Co. v. Bushmiaer*[47] also established that market prices are a significant component in developing market value.[48]

> [I]f there be no market value at the place of delivery, the value of the goods or other product should be determined at the nearest place where they have a market value, deducting the extra expense of delivering them there. The prices prevailing at the nearest place where the product can be sold, less transportation and distributing charges, show the value of such product at the place of delivery as nearly as it is possible to show such value.[49]

b. Terms of Location

- Off the Premises
- At the Well
- Into the Pipeline

The term "off the premises" has been well established since *Middleton*:[50]

> We conclude "off the premises" modifies both "sold" and "used." The "premises" is the land described in the lease agreement. Therefore, sold "off the premises" means gas which is sold outside the leased premises. Thus, "sold at the wells" means sold at the wells within the lease, and not sold at the wells within the fields.[51]

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[46] Shamrock Oil & Gas Corp. v. Coffee, 140 F.2d 409, 410-11 (5th Cir. 1944) (applying Texas law) (emphasis added).

[47] 264 S.W. 830 (Ark. 1924).

[48] *Bushmiaer*, 264 S.W. at 832.

[49] *Id.*

[50] 613 S.W.2d 240 (Tex. 1981).

[51] *Middleton*, 613 S.W.2d at 243. This Texas case dealt with a non-unitized well and lease. Although no precedent has been found, arguably the State Conservation statutes which require lessees to unitize or pool leases, in order to drill wells would have the effect of establishing the pooled unit boundary as the "pre-

In *Middleton* the terms "off the premises" and "at the well" were used in complementary fashion to the effect that "at the well" was synonymous with "on the premises." However, the gas being sold and used in *Middleton* was evidently not subject to any quality variation, which was a key factor in the Fifth Circuit Court of Appeals' determination of the meaning of "at the well" in *Piney Woods Country Life School v. Shell Oil Co.*[52]

> In Part III of this opinion, we discussed the purposes of distinctions between "amount realized" and "market value at the well." *We concluded that "at the well" refers not only to the place of sale but also to the condition of the gas when sold.* "At the well" means that the gas has not been increased in value by processing or transportation. It has this meaning in conjunction with "value" or "amount realized" as well as with "sold."[53]

"At the well" has thus been defined by at least one court as a reference back to the natural state of the natural gas at the time produced.[54] Thus, where the royalty share is determined "at the well" whether on an amounts realized or market value basis, a sale of the product away from the lease or unit premises will establish the condition necessary for deductibility of treatment costs after production.

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mises" for purposes of the royalty provision. This is supported by both the pooling provisions of most leases and pooling provisions of most conservation statutory pooling schemes which spread the royalty obligation proportionately within the pooled unit instead of just the lease premises upon which the well is located.

[52] 726 F.2d 225 (5th Cir. 1984) (applying Mississippi law).

[53] *Piney Woods*, 726 F.2d at 240 (emphasis added).

[54] As noted by Professor Anderson, this phrase is inaccurate as well as inartful. Anderson, *supra* note 35, at 635. Gas at the well is generally not in any condition for sale or transportation until it has gone through traditional field separation facilities to eliminate water, oil or other impurities. *Id.* at 634. Field separation facilities are generally located at each well site and are installed as a part of operations to drill and complete the well, at the sole expense of the lessee. *Id.* As such, "at the well" really means gas that has left the on-lease field separation facilities. *Id.* at 642. Thus, perhaps "on site" is more accurate and should be utilized in lease forms instead of "at the well."

Typical oil royalty clauses provide for delivery of oil "free of cost, in the pipeline."[55] "Consistent with nearly all case law" addressing this phrase, it "contemplates that the lessee must absorb all cost of delivering oil or gas into a pipeline near the well," but creates no obligation "to deliver oil or gas to some distant pipeline or market."[56] Professor Anderson also suggests that this phrase may also be interpreted to mean that the lessee is obligated to pay royalty on gas of pipeline quality.[57] In other words, this phrase is not only a term of location but a term of quality also.[58]

Texas cases apparently treat "at the well" differently from "in the pipeline." "At the well" has now been confined to anywhere on the leased premises, perhaps closer.[59] However, no court has apparently confined the phrase "free of cost, in the pipeline" to the leased premises.

> For the sake of uniformity, courts should decide either that "at the well" means at the wellhead or that it is essentially a synonym for "free of cost, in the pipeline" and does not add anything to leases that are silent as to location. Which view is better is debatable. The former view recognizes a plain meaning difference in these terms regarding transportation expense and most likely reflects the lessee's intent in using the words "at the well." The latter view promotes uniformity in the calculation of royalty under various royalty clauses.[60]

4. Calculating "Market Value at the Well"

As a matter of proof, the first and preferred method of establishing market value at the well is to utilize "comparable gas sales."

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[55] *Id.* at 650.

[56] *Id.* (citing Rains v. Ky. Oil Co., 255 S.W. 121 (Ky. Ct. App. 1923) and Scott v. Steinberger, 213 P. 646 (Kan. 1923) for support of proposition).

[57] *Id.*

[58] *Id.* at 650 n.147. This reasoning was also expressed in *TXO Prod. Corp. v. State*, 903 P.2d 259 (Okla. 1994).

[59] Anderson, *supra* note 35, at 651-52 (citing *Middleton*, 613 S.W.2d 240, 244 and *Heritage Res., Inc. v. NationsBank*, 939 S.W.2d at 122-23 (Tex. 1996), for support of proposition).

[60] *Id.* at 652.

> Comparable sales of gas are those comparable in time, quality, quantity, and availability of marketing outlets . . . . Sales comparable in time occur under contracts executed contemporaneously with the sale of the gas in question. Sales comparable in quality are those of similar physical properties such as sweet, sour, or casinghead gas. Quality also involves the legal characteristics of the gas; that is, whether it is sold in a regulated or unregulated market, or in one particular category of a regulated market. Sales comparable in quantity are those of similar volumes to the gas in question. To be comparable, the sales must be made from an area with marketing outlets similar to the gas in question. Gas from fields with outlets to interstate markets only, for instance, would not be comparable to gas from a field with outlets only to the intrastate market.[61]

Where it is determined that there are no comparable gas sales, then the next most desirable method of proving market value at the well is to take the nearest "market prices" and net back the transportation and compression costs necessary to transport gas from the well to the location of the market prices.[62] Where there are no sales of comparable gas anywhere, then the least desirable method of determining market value is to take the actual sales price of the gas, where sold, and subtract from that sales price all post-production costs actually incurred between the field separating facilities and the point of sale.

Under the standard gas royalty clause, the deduction of post-production expenses is *only* available when (1) there are no comparable sales "at the well" and (2) the royalty clause in question specifically requires computation of the royalty at a point different than the point of sale.[63]

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[61] *Middleton*, 613 S.W.2d at 246-47 (footnote omitted).

[62] Clear Creek Oil & Gas Co. v. Bushmiaer, 264 S.W. 830, 832 (Ark. 1924).

[63] For example, in *Piney Woods*, the court construed seven different royalty provisions after determining that the gas was actually sold at the tailgate of the processing plant. Piney Woods Country Life Sch. v. Shell Oil Co., 726 F.2d 225, 228-29 (5th Cir. 1984) (applying Mississippi Law). It held that post-production costs could be deducted under royalty provisions requiring payment of "market value at the well" for gas sold or used off premises as well as all cases where

> We emphasize, however, that processing costs are chargeable [to the royalty interest] only because, under these leases, the royalties are based on value or price at the well. Processing costs may be deducted only from valuations or proceeds that reflect the value added by processing. Thus, processing costs may not be deducted from royalties for gas "sold at the well", because the price of such gas is based on its value before processing.[64]

B. The Lessee's Duty to Market

An obligation to market oil or gas, once produced, is generally unstated in most standard lease forms. However, it is generally recognized as one of the standard "implied covenants" enforced by courts since the 1905 case of *Brewster v. Lanyon Zinc*.[65] While numerous systems classifying implied covenants have been suggested over the years, the following list of implied covenants, proposed by Professor Richard Hemingway, is the most generally accepted:

> 1. The implied covenant to develop the lease, which includes the covenants to (a) drill an initial well, and (b) develop the lease once production is obtained;
> 2. The implied covenant to protect the lease, which includes the covenants to (a) protect the lease against drainage, and (b) abstain from depreciating the lessor's interests; and
> 3. The implied covenant to manage and administer the lease, which includes the covenants to (a) . . . market production and (b) operate [prudently, using] modern methods of production and development, and seek[ing] favorable administrative action.[66]

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the lease requires payment of the royalty based on "the amount realized by lessee, computed at the mouth of the well." *Piney Woods*, 726 F.2d 240-41.

[64] *Id.*

[65] Brewster v. Lanyon Zinc, 140 F. 801 (8th Cir. 1905) (applying Kansas law).

[66] Scott Lansdown, *The Implied Marketing Covenant in Oil and Gas Leases: The Producer's Perspective*, 31 ST. MARY'S L.J. 297, 302-03 (2000) (citing RICHARD W. HEMINGWAY, THE LAW OF OIL AND GAS § 8.1 (3d ed. 1991)).

Although the implied covenant to market has generally received less attention than other implied covenants, it has been recognized for more than 90 years.[67] Early application was generally limited to "the complete failure of a lessee to produce and market gas."[68] In the 1970s and 1980s, courts "focused on allegations that the lessee failed to obtain an appropriate price" as the market value began to greatly exceed long-term contracts.[69] The latest evolution, now commonly referred to as the "marketable condition" rule, involves attempts by lessors to apply the covenant to define the benefits and expenses that should be allocated to a lessor under an oil and gas lease.

1. Initial Development

Because of the uncertainties surrounding the development of oil and gas resources under an oil and gas lease,

> oil and gas leases seldom describe, with much specificity, the obligations of the lessee with regard to the drilling and operation of the lease. Courts thus have recognized that the parties to the lease probably do not intend to leave such matters to the unfettered discretion of the lessee . . . [and] adopted a group of implied covenants deemed to be included in all oil and gas leases in the absence of express language to the contrary.[70]

In construing and enforcing these implied covenants, there are two interpretive standards most courts consider before enforcing an implied covenant against the lessee. First, because most "implied covenants are derived from the presumed intentions of the parties to the lease, they should not be imposed if doing so would be inconsistent with the express provisions of

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[67] *See* Howerton v. Kan. Natural Gas Co., 106 P. 47 (Kan. 1910), *rev'd on other grounds*, 108 P. 813 (Kan. 1910).

[68] Lansdown, *supra* note 66, at 304.

[69] *Id.* at 305. *Compare* Hillard v. Stephens, 637 S.W.2d 581 (Ark. 1982), *with* Diamond Shamrock Corp. v. Harris, 681 S.W.2d 317 (Ark. 1984), *and* Taylor v. Ark. La. Gas Co., 793 F.2d 189 (8th Cir. 1986), *with* Klein v. Jones, 980 F.2d 521 (8th Cir. 1992).

[70] Lansdown, *supra* note 66, at 299.

the lease."[71]

> An implied covenant is one which may reasonably be inferred from the whole agreement and the circumstances attending its execution. Implication when used in that sense is synonymous with intention. An express covenant upon a given subject, deliberately entered into without fraud or mutual mistake, excludes the possibility of an implied covenant of a different or contradictory nature.[72]

The second interpretive standard is the standard of conduct by which a lessee would be judged in performance of an implied covenant. Since *Brewster v. Lanyon Zinc Co.*,[73] most jurisdictions have used the "reasonable prudent operator" standard which "only requires that a lessee take actions that will be mutually beneficial for itself and its lessor."[74] This standard does not require the lessee to take actions that would be unprofitable to the lessee.[75] The only modification to this standard that has received any support is the addition of "greater scrutiny" in cases where the interest of the lessor and lessee obviously conflict.[76] This most often occurs when the lessee has entered into a marketing contract with an affiliate company.[77]

Throughout much of the history of the oil and gas industry, the implied covenant to market had no interplay with royalty valuation simply because regulated gas prices were very stable and there was very little distinction between long-term gas

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[71] *Id.* at 304-05.

[72] *Id.* (citing Brimmer v. Union Oil Co., 81 F.2d 437 (10th Cir. 1936)).

[73] 140 F. 801 (8th Cir. 1905).

[74] Lansdown, *supra* note 66, at 308; *see also* Ainsworth v. Callon Petroleum Co., 521 So. 2d 1272 (Miss. 1987) (holding that because operator acted prudently in entering long term fixed price contract, no breach of implied duty to market occurred).

[75] Lansdown, *supra* note 66, at 308.

[76] *Id.* at 309.

[77] *See* Klein v. Jones, 980 F.2d 521 (8th Cir. 1992) (involving buy down of take-or-pay contract between lessee and affiliated pipe line company); Parker v. TXO Prod. Corp., 716 S.W.2d 644 (Tex. App. 1986) (discussing sale of gas to wholly-owned subsidiary at well which deducted 5% compression charge from resale price to third party).

purchase contract prices and "market value." However, beginning with *Vela*, royalty valuation under market value leases was decoupled from the long-term gas purchase contracts.[78] Thus, even if a lessee was deemed to have complied with the implied covenant to market, the express royalty provisions required payment based on valuations unrelated to that marketing effort.[79] Three states—Oklahoma, Arkansas and Louisiana—all refused to separate the lessee's marketing efforts from the royalty obligation.[80] Oklahoma and Arkansas specifically rejected the *Vela-Middleton* approach.[81] Louisiana reached a similar result, holding that "market value" meant the market value of gas "at the time the gas was originally dedicated to the contract."[82]

One commentator suggests that implied covenants, especially the covenant to market, is based on three models: equity, contract, and policy.[83] The equity model presumes unfairness to lessors and attempts to equalize the superior bargaining power of lessees in the form leases by looking at the actual language merely as evidence, not controlling of the party's intentions.[84] The contract model assumes the language of the lease expresses the party's reasonable expectations and that covenants are implied to add to the express expectations "given the nature and purpose . . . and the circumstances under which [the contract] was made."[85] The policy model considers values, usually "legislated expressions," that are "external to the

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[78] *See Vela*, 429 S.W.2d at 866.

[79] The proposition in *Vela* was upheld by *Exxon Corp. v. Middleton*, 613 S.W.2d 240 (Tex. 1981), and is now followed by a majority of the producing states. *See* Lansdown, *supra* note 66, at 313-14 (providing list of states and citations).

[80] Lansdown, *supra* note 66, at 313-14.

[81] *Id.* (citing Hillard v. Stephens, 637 S.W.2d 581 (Ark. 1982); Tara Petroleum Corp. v. Hughey, 630 P.2d 1269 (Okla. 1981)).

[82] Lansdown, *supra* note 66, at 314 (citing Henry v. Ballard & Cordell Corp., 418 So. 2d 1334, 1341 (La. 1982)).

[83] Jacqueline Lang Weaver, *When Express Clauses Bar Implied Covenants, Especially in Natural Gas Marketing Scenarios*, 37 NAT. RESOURCES J. 491, 492-93 (1997).

[84] *Id.*

[85] *Id.* at 493.

party's expectations or to judicial norms of equity."[86] Most jurisdictions that have adopted the *Vela-Middleton* rule follow the contract model, using equity only when deemed necessary to promote fairness to both lessor and lessee.[87]

2. *The "Marketable Condition" Extension*

Although a number of commentators had been advocating this viewpoint, the use of the implied covenant to market as a basis for holding that no cost could be charged to royalty owners until the product was marketable was first given judicial blessing in *Wood v. TXO Production Co.*,[88] where the court stated: "In our view, the implied duty to market means a duty to get the product to the place of sale in marketable form."[89] In *Wood*, the Oklahoma Supreme Court was responding to a certified question on whether compression costs could be deducted from royalty payable "at the market price at the well."[90]

This "marketable condition" ruling was immediately extended to all dehydration and gathering costs in *TXO Production Corp. v. Commissioners of the Land Office*.[91] This rationale was also adopted by Kansas in *Sternberger v. Marathon*

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[86] *Id.*

[87] *Id.* at 497-502. This section discusses a number of cases relevant to this point, including *Danziger Oil & Refining Co. v. Powell*, 154 S.W.2d 632 (Tex. 1941), *Cowden v. Broderick & Calvert, Inc.*, 114 S.W.2d 1166 (Tex. 1938) and *Freeport Sulphur Co. v. American Sulphur Royalty Co.*, 6 S.W.2d 1039 (Tex. 1928). *See also* Klein v. Jones, 980 F.2d 521 (8th Cir. 1992) (using unjust enrichment and policy models to evaluate breach of marketing covenant); Millette v. Phillips Petroleum Co., 48 So. 2d 344 (Miss. 1950) (holding express offset well clause does not bar implied covenant not to drain oil).

[88] 854 P.2d 880 (Okla. 1992).

[89] *Wood*, 854 P.2d at 882. For a discussion of the positions taken by most of the major commentators on the duty, if any, of the lessee to market production free of costs, see Anderson, *supra* note 9, at 604-09.

[90] *Wood*, 854 P.2d at 880. The *Wood* opinion has been harshly criticized as being "based on suspect authority and [] insupportable under prior Oklahoma case law." R. Kevin Redwine & Steven G. Heinen, *Deductibility of Natural Gas Compression Costs in Light of* Fox Wood III v. TXO Production Co., 29 TULSA L.J. 677, 679 (1994).

[91] 903 P.2d 259, 262 (Okla. 1994).

Oil Co.[92] for compression costs but not for gathering costs.[93]

In *Garman v. Conoco, Inc.*,[94] the Colorado Supreme Court adopted the marketable condition rule and even applied it to overriding royalty interests.[95] However, the Colorado Supreme Court, in fashioning its rule, stepped back from the extreme position announced in *Wood*:

> Upon obtaining a marketable product, any additional costs incurred to enhance the value of the *marketable* gas, such as those costs conceded by the Garmans, may be charged against nonworking interest owners. To the extent that certain processing costs enhance the value of an already marketable product the burden should be placed upon the lessee to show such costs are reasonable, and that actual royalty revenues increase in proportion with the costs assessed against the nonworking interests.[96]

In *Mittelstaedt v. Santa Fe Minerals, Inc.*,[97] Oklahoma shifted its position on the marketable condition rule back towards *Garman* by stating that once production of a marketable product had been reached, lessees could charge royalties for costs incurred, so long as the lessee can demonstrate "(1) that the costs enhanced the value of an already marketable product, (2) that such costs are reasonable, and (3) that the actual royalty revenues increased in proportion with the costs assessed against the [royalty] interest."[98]

Professor Anderson believes that the Colorado, Oklahoma and Kansas courts have provided the most appropriate application of the marketable condition extension of the duty to market.[99] On the other hand, Lansdown argues that the determination of the point when production becomes marketable is

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[92] 894 P.2d 788 (Kan. 1995).
[93] *Sternberger*, 894 P.2d at 802-04.
[94] 886 P.2d 652 (Colo. 1994).
[95] *Garman*, 886 P.2d at 659-60.
[96] *Id.* at 661 (footnotes omitted).
[97] 954 P.2d 1203 (Okla. 1998).
[98] *Mittelstaedt*, 954 P.2d at 1205 (footnote omitted).
[99] Anderson, *supra* note 35, at 669-72, 683-93.

practically unworkable and it legally should be considered irrelevant to the implied covenant to market.[100]

III. The Clash of Royalty Valuation vs. The Duty to Market

Gas royalty is a *quantitative* valuation which concludes with an obligation to pay to the lessor a specific amount of money calculated according to the lease terms. The duty to market, on the other hand, is a *qualitative* evaluation of the performance, by lessee, under the reasonable prudent operator standard. As Mr. Lansdown stated in his article:

> The fundamental problem with applying the implied marketing covenant to cases involving post production costs is that the allegations in such cases have nothing to do with the prudence exercised by the lessee in marketing production. None of the royalty owners in the recent post production cases argued that the lessee was imprudent in its marketing efforts. Rather they argued that the lessee's deduction of post production costs in determining royalty was inappropriate. The only connection between the royalty owners' allegations and the implied marketing covenant was that the lessee had the obligation to place production in marketable condition. However, the failure of courts or commentators to define with any degree of specificity, what marketable condition means renders the rule essentially meaningless. Furthermore, even assuming that there is some obligation to place production in marketable condition, this obligation has nothing to do with the question of whether post production costs should be included in the determination of royalty.[101]

Where these two different concepts run together, and clash, is evaluated below based on the type of lease royalty provision at issue.

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[100] Lansdown, *supra* note 66, at 335-38.

[101] *Id.* at 335-36.

A. The Market Value Clause

In jurisdictions which still follow the *Vela-Middleton* rule, there is a valid argument that the disconnection between market value royalty obligation and the lessee's actual market contract should also disconnect any implied marketing obligation from the royalty value obligation. Indeed, a number of commentators have suggested just that.[102] At least one Texas court has followed that rationale and ruled in favor of the lessee in a "reverse *Vela-Middleton*" claim approving lessees' payment to lessors of a royalty based on market price that was less than the price actually received by lessee under its sales contract.[103]

However, Texas courts will continue to apply the traditional duty to market concept where the lessee has some control over the market price. In *Shelton v. Exxon Corp.*,[104] the federal court found Exxon in breach of its duties to prudently market the lessor's gas for continuing to use that gas under a corporate warranty contract at the time the Natural Gas Policy Act of 1978 was enacted, thereby establishing a ceiling price (and market) for the gas.[105] The court found that Exxon, as a reasonably prudent operator, should have been aware of the eminent passage of the Natural Gas Policy Act that would classify gas into different categories with different price ceilings.[106] Thus, the court reasoned, it was imprudent for Exxon to continue marketing the gas in a manner that limited its market value to a lower federally-controlled price than could have been received.[107] In *Cabot Corp. v. Brown*,[108] the Texas

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[102] Weaver, *supra* note 83, at 522 & n.128.

[103] de los Santos v. Coastal Oil & Gas Corp., No. 05-97-00029, 1999 WL 619639, at *3-4 (Tex. App. – Aug. 17, 1999, no writ). *But see* Weaver, *supra* note 83, at 528-30 (presenting three arguments lessors might make against the reverse *Vela-Middleton* scenario).

[104] 719 F. Supp. 537 (S.D. Tex. 1989), *rev'd on other grounds*, 921 F.2d 525 (5th Cir. 1991).

[105] *Shelton*, 719 F. Supp. at 548-49.

[106] *Id.* at 549.

[107] *Id.*

[108] 754 S.W.2d 104 (Tex. 1988).

Supreme Court also recognized that the implied covenant to market could still be used to enforce rights in a market value lease where the lessee has some control over the market price.[109] The court stated:

> Included within the covenant to manage and administer the lease is the duty to reasonably market the oil and gas produced from the premises. This duty is also two-pronged: the lessee must market the production with due diligence and obtain the best price reasonably possible. Under a gas royalty clause providing for royalties based on market value, the lessee has an obligation to obtain the best current price reasonably available.[110]

Both *Wood* and *Sternberger* involved market value provisions of leases and the issue of whether or not to deduct post-production costs therefrom.[111] Both cases relied on the implied covenant to market as creating a duty on the lessee to bring the gas to "marketable condition" free of cost to the lessor. However, the Oklahoma Supreme Court in *Wood* held that the implied duty to market imposed "a duty to get the product to the place of sale in marketable form" and, therefore, compression costs were not deductible.[112] On the other hand, the Kansas Supreme Court, in *Sternberger*, allowed deduction for the cost of constructing and operating a gathering line because there was no evidence presented that the gas produced by the lessee was not marketable at the mouth of the well.[113] The differing results in these cases point out a fundamental difficulty presented by the application of the "marketable condition" rule and royalty valuation issues:

> [V]irtually all gas that is produced is, in some sense, marketable. Gas that is "sour," *i.e.,* gas containing relatively high amounts of sulfur, is marketable to a purchaser possessing sweetening facilities. Gas that is under low pressure is mar-

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[109] *Brown*, 754 S.W.2d at 107-08.
[110] *Id.* at 106 (citations omitted).
[111] *See supra* notes 88-93 and accompanying text.
[112] *Wood*, 854 P.2d at 882.
[113] *Sternberger*, 894 P.2d at 799.

> ketable to a purchaser possessing compressors. Similarly, gas that contains excessive water is marketable to a party possessing a dehydration facility. Such gas can only be said to be not marketable in the sense that there are no such purchasers ready and willing to purchase the gas in the area of the well from which the gas is being produced. However, the *Sternberger* opinion expressly stated that the absence of an immediate purchaser was not an impediment to marketability.[114]

As discussed by Lansdown,

> [D]isallowing deductions in situations where the lessee has the option of performing a post production operation or selling the product at the wellhead to a buyer to perform the operation may dissuade the lessee to engage in an operation that would enhance the value [or reduce the cost] of the product, resulting in a higher economic return for both the lessor and lessee.[115]

This is an irrational result, the likelihood of which "has been increased by the restructuring of the gas market because the restructuring has extended the range of marketing opportunities under which a lessee may realize an economic benefit through post production activities."[116]

B. The Amounts Realized or Proceeds Clause

Since the royalty valuation is directly dependent on the marketing capability of lessees under this provision, there is a much more direct connection between the lessee's duty to reasonably market the production and the royalty obligation. The clash between these two provisions usually arises in the context of a lessee's attempt to manipulate the proceeds by con-

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[114] Lansdown, *supra* note 66, at 333.

[115] *Id.* at 338 (citing David E. Pierce, *Royalty Valuation Principles in a Changing Gas Market*, STATE BAR OF TEX. PROF. DEV. PROGRAM, ADVANCED OIL, GAS & MINERAL LAW COURSE E, E-17 (1993)).

[116] *Id.* at E-18, E-19.

tracting with an affiliated company to market the gas.[117] In today's open access, non-discriminatory gas market,

> producers have the theoretical ability to sell to markets as distant as the city gate and, in some cases, the burner tip. To access these markets, however, requires expertise, manpower, and financial creditworthiness which many [independent] producers do not possess. It also requires participants to take on new liabilities not associated with the exploration and production of natural gas. To protect their gas reserves and . . . assets from liability for such risks, it is not uncommon for producers to create affiliates in order to separate their exploration and production business from . . . downstream [transportation and] marketing of natural gas.[118]

Thus, "when the sales of production are made to an affiliate or an affiliate is used to provide downstream [transport or processing] services, the question arises whether royalties can be properly paid on the basis of the proceeds received by the lessee" from such sale, rather than the affiliate at the other end of such transportation facilities.[119] Matlock's articles propose that the following guidelines should be observed when entering this arena:

> (1) The mere existence of affiliates in marketing transactions should not constitute a *per se* breach of the express or implied covenants of the lease. [However, it is inherently suspect and triggers a close scrutiny to the affiliate transaction.]
>
> . . .
>
> (3) In all of the cases in which the lessee has survived the inquiry triggered by the existence of an affiliate in the marketing transaction, there was independent evidence of the

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[117] For an excellent discussion of this topic, see Judith M. Matlock, *Payment of Gas Royalties in Affiliate Transactions*, 48 INST. ON OIL & GAS L. & TAX'N 9-1 (1997).

[118] *Id.* at 9-3, 9-4.

[119] *Id.* at 9-9.

> fairness or competitiveness of the sales price on which the lessee had paid royalties.[120]

Further, a proceeds royalty clause does not protect the lessee where its business interests in a marketing transaction clearly differ from the lessor's. *Amoco Production Co. v. First Baptist Church of Pyote*[121] involved a proceeds royalty clause under which Amoco was paying royalties based on the gas contract price it had negotiated for that field.[122] The royalty owner, however, argued that the lessee had violated its duty to market by agreeing to sell gas from his well at a low price in order to renegotiate a higher price on gas sold from an existing well.[123] With evidence of gas produced from the same well being sold by other lessees for approximately twice the amount for which Amoco was selling its gas, the court found Amoco to be in breach of its implied duty to market and ordered payment at the market rate.[124] The Texas Supreme Court affirmed, noting that the result in the case did not imply that the implied marketing covenant had the effect of converting a proceeds lease into a market value lease.[125]

C. The Marketable Condition Rule is a Mistake

After careful consideration of both the origin and development of the marketable condition extension, as well as a close reading of the previously published arguments made by learned attorneys and commentators, it seems somewhat apparent that the marketable condition rule, though perhaps well-intentioned, is a mistake that should die the same way it was conceived.[126] This conclusion is drawn historically, relationally, and for the sake of uniformity.

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[120] *Id.* at 9-37.

[121] 579 S.W.2d 280 (Tex. App. 1979), *writ ref'd n.r.e.*, *aff'd* 611 S.W.2d 610 (Tex. 1980).

[122] *Amoco Prod. Co.*, 579 S.W.2d at 282.

[123] *Id.* at 283-84.

[124] *Id.* at 234.

[125] Amoco Prod. Co. v. First Baptist Church, 611 S.W.2d 610, 610 (Tex. 1930).

[126] *See supra* notes 88-100, 114-16 and accompanying text.

Historical derivations of the term "royalty" have resulted in differing conclusions about whether lessees historically had to bear all of the costs to render the mined product marketable for the purposes of royalty.[127] Those discussions beg the question because they concentrate on "royalty," generally, not the modern oil and gas lease royalty clause. This author's research indicates that, under the modern oil and gas lease royalty clause in America, the earliest cases treating responsibility for post-production charges have uniformly indicated such costs should be shared between Lessor and Lessee.[128] Moreover, even the commonly used definition of oil and gas royalty: "a share of oil and gas production, free of expenses of production," is not entirely accurate. The royalty owner has historically borne a share of the cost of production and initial treatment of oil and gas in that it received no royalty on oil or gas produced but used by the lessee on the leased premises for those purposes. The fuel necessary to produce and initially treat oil and gas can be a substantial component of the lease operating expenses. The royalty owner is in essence contributing its share of those expenses by contractually foregoing any proceeds. This

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[127] Anderson, *supra* note 9, at 571-603; *accord*, Lowe, *supra* note 10, at 257-61.

[128] *See* Molter v. Lewis, 134 P.2d 404 (Kan. 1943) ("It is the duty of the lessee to see that the oil is marketed, but this general duty does not mean that the lessee must pay the transportation charge of the lessee's share of the oil from the well to some distant place."); Wall v. United Gas Pub. Serv. Co., 152 So. 561, 564 (La. 1934) (holding lessee not required to bear "all the expense of carrying the gas to a market beyond the gas field."); Crichton v. Standard Oil Co., 150 So. 668, 669 (La. 1933) (stating cost to make gas merchantable should be deducted before computing lessor's royalty); Cimarron Util. Co. v. Safranko, 101 P.2d 258, 260 (Okla. 1936) ("market value is synonymous with actual value, and may be proved by showing the selling price less the expense of marketing the commodity."); Katschor v. Eason Oil Co., 63 P.2d 977, 981 (Okla. 1936) (noting royalties to be calculated "by showing the sale price of the gasoline and the residue gas and deducting from the sum thereof the cost of manufacture of the gas after production, plus depletion of the plant and cost of marketing the gasoline and residue gas."). Texas arrived at a similar conclusion holding that expenses involved in processing a product subsequent to production did not come within the term "operating expenses." Danciger Oil & Refineries, Inc. v. Hamill Drilling Co., 171 S.W.2d 321, 323 (Tex. 1943). As such, the lessee "was not entitled to share in the increase received from sale of the processed products. That is, the royalty was based on the value of the gas at the point of production (at the mouth of the well)." Martin v. Glass, 571 F. Supp. 1406, 1412 (N.D. Tex. 1983) (discussing *Danciger Oil & Refineries*).

often significant contribution by the royalty owner has been ignored by previous commentators and, moreover, is in direct conflict with their contention that the royalty owner has no historical or contractual obligation to bear any expenses associated with getting his production to market.

The relationship between a lessor and a lessee also does not support the conclusion that a lessee must bear all costs associated with making produced oil or gas marketable. The great majority of jurisdictions judge this relationship under the prudent operator standard. Under that standard, a lessee only owes an obligation to act, provided the evidence indicates that a lessee, in acting, can make a reasonable profit. There is no authority under the prudent operator standard requiring a lessee to bear all costs, or preventing it from making a profit with regard to the production and sale of oil or gas produced under a lease.[129] Even if one accepts the description of this relationship as a "cooperative venture," that description does not imply that the Lessee must absorb all costs associated with the operations.[130] Comparing the lessor/lessee relationship with what is probably the most analogous legal relationship to a "cooperative venture"—a joint adventure—the parties must share not just in the profits, but the costs and losses as well. The law in most jurisdictions has several fundamental elements that must be found in the relationship for it to be declared a joint venture. These include both an agreement to share in profits and an agreement to share in losses.[131] A lack

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[129] A fiduciary relationship, which generally prohibits the fiduciary from making a profit with regard to activities on behalf of the beneficiary, has been uniformly rejected in describing the oil and gas lessor/lessee relationship. *See, e.g.*, Mitchell Energy Corp. v. Samson Res. Co., 80 F.3d 976, 985 (5th Cir. 1996) ("Under Texas law neither a cotenancy nor a lessor/lessee relationship imports a fiduciary relationship."); Cambridge Oil Co. v. Huggins, 765 S.W.2d 540, 544 (Tex. App. 1989), *writ denied* ("The relationship between a lessor and lessee is purely contractual," therefore fiduciary duties do not apply.).

[130] *See supra* note 30 and accompanying text.

[131] "A joint venture can be readily defined as a legal entity in the nature of a partnership engaged in the joint undertaking of a particular transaction for mutual profit where generally all contribute assets and share risks." Pittman v. Webber Energy Corp., No. 98-CA-00358-COA, 2000 WL 823451, at *4 (Miss. App. June 27, 2000) (citation omitted). "[A]ctual intent to form a joint venture is essential." Hults v. Tillman, 480 So. 2d 1134, 1143 (Miss. 1985). Furthermore, the

of an agreement to share in losses is fatal to the existence of a joint venture.[132]

Furthermore, the contractual basis raised by Professor Maurice Merrill in arguing for this marketable condition rule is tenuous at best.[133] His argument is based on the general proposition that any party with an obligation under a contract is required to perform that obligation without cost to the other party, absent any express provision to the contrary.[134] The use of this argument for the marketable condition extension is extremely troubling because the obligation to market under an oil and gas lease is implied, not express. Professor Merrill's general contractual statement deals with express obligations, while presuming a party's obligation to bear costs associated with such an express obligation to the contract.[135] In using this general proposition with the implied obligation to market under an oil and gas lease, Professor Merrill seeks to extend this contractual implication to another implication. It is suggested such "double implication" stretches a court's ability to presume too far. Further, this implication upon an implication

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Hults court, citing Williston on Contracts, held that

> it can be said that joint adventure contemplates an enterprise jointly undertaken, that it is an association of such joint undertakers to carry out a single project for profit; that the profits are to be shared, as well as the losses, though the liability of a joint adventure for a proportionate part of the losses or expenditures of the joint enterprise may be affected by the terms of the contract. There must be a contribution by the parties to a common undertaking to constitute a joint adventure; and a community of interest as well as some control over the subject matter or property right of the contract.

Id. at 1142 (citing 2 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS 554 (3d ed. 1959)).

[132] Gross v. Chevrolet Country, Inc., 655 So. 2d 873, 878 (Miss. 1995) (citing *Hults*, 480 So. 2d at 1142-43); *see also* Cimarron Oil & Gas, Inc. v. Benson-McCown & Co., 806 P.2d 83, 85 (Okla. Ct. App. 1989) (stating absence of provision that party would "share in the profits and losses of the program . . . alone negates the existence of a joint venture under [Oklahoma law]."); Swinehart v. Stubbeman, McRae, Sealy, Laughlin & Browder, Inc., No. 14-99-00717-CV, 2001 WL 224945, at *8 (Tex. App. March 8, 2001) ("If the parties do not agree to share losses, no joint venture will be implied.").

[133] *See* MAURICE H. MERRILL, COVENANTS IMPLIED IN OIL AND GAS LEASES 212-23 (2d ed. 1940).

[134] *See id.*; *see also* E. ALLAN FARNSWORTH, CONTRACTS § 9.6 (2d ed. 1990).

[135] *See* Merrill, *supra* note 133, at 214-15.

ignores the historical terms of art now used in the standard royalty provisions which arguably do express the intention of the parties with regard to sharing costs.[136]

Finally, a number of commentators, particularly Professor Owen Anderson, advocate a "uniform regime of royalty law," for the sake of avoiding inconsistent judicial decisions and bringing a realm of certainty to lease transactions.[137] Indeed, such a uniform regime of royalty law would be closer to reality if the marketable condition rule were eliminated. Oklahoma, which was the first state to adopt the marketable condition rule, has backtracked considerably since it held in *Wood v. TXO Production Co.* that the implied duty to market meant a duty to get the product to the place of sale in marketable form.[138] Both Colorado and Oklahoma have now adopted a less extreme position that allows certain post-production costs to be deducted where the following three conditions are proved by the lessee:

1. The product is already marketable when the post-production operation is applied;
2. The costs of that operation are reasonable; and
3. The actual royalty revenues increase in proportion with the costs assessed against the royalty owner.[139]

Piney Woods Country Life School v. Shell Oil Co.,[140] considered a prototype for "plain terms" analyses of post-production expenses, is not as far from Colorado and Oklahoma as many people might think. In *Piney Woods*, the Fifth Circuit was called on to determine whether or not post-production costs associated with clearly unmarketable sour gas was deductible from Shell proceeds.[141] The gas stream of wells in *Piney Woods* contained 35% hydrogen sulfide (H_2S).[142] Shell had created a formula for processing costs that included not only actual operating expenses of the plant, but also the reimburse-

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[136] *See supra* Part II.A.3.

[137] *See supra* notes 22-233 and accompanying text.

[138] *See supra* notes 88-98 and accompanying text.

[139] *See supra* notes 94-98 and accompanying text.

[140] 539 F. Supp. 957 (S.D. Miss. 1982), *aff'd in part, rev'd in part*, 726 F.2d 225 (5th Cir. 1984).

[141] *Piney Woods*, 539 F. Supp. at 960.

[142] *Id.* at 963.

ment of capital investment for the plant (depreciation) with a return on that investment calculated at 15%.[143] Finally, the formula for deducting these costs included a 50% ceiling on the percentage of costs that could be deducted from proceeds attributable to the royalty interest.[144] The Fifth Circuit ultimately held that processing could be deducted, but gave two restrictions on remand: "The processing costs must be reasonable) [and] . . . [they must] be deducted only from valuations or proceeds that reflect the *value added* by processing."[145] These two factors—"reasonableness" and "whether the cost is proportional to the value added by the operation"—are two of the three factors required in both Colorado's *Garman* and Oklahoma's *Middelstaedt* in determining the deductibility of post-production charges.[146] If the "marketable condition" requirement is eliminated in Colorado and Oklahoma, the requirements for deductibility of post-production costs in most jurisdictions would be fairly uniform. Furthermore, requiring a lessee to prove its post-production expenses are reasonable and proportional to the value added by the operation is a sufficient safeguard for fair dealing under the traditional "prudent operator" relationship between the lessor and lessee.

IV. Overrides and Severed Royalty: Does it Make a Difference?

Two of the key "marketable condition" cases—Colorado's *Garman v. Conoco, Inc.*[147] and the Kansas case of *Sternberger v. Marathon Oil Co.*[148]—involved a determination of the deductibility of post-production costs from royalty due to overriding royalty interest owners. Because these opinions discuss

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[143] *Id.* at 963-64.

[144] *Id.* at 974.

[145] Piney Woods Country Life Sch. v. Shell Oil Co., 726 F.2d 225, 240-41 (5th Cir. 1984) (emphasis added). On remand, in an unreported 1989 opinion, the *Piney Woods* trial court upheld these processing charges by expressly finding that the cost of processing the sour gas into marketable, sweet gas was reasonable and proportional to the value added by the processing.

[146] *See supra* notes 94-98 and accompanying text.,

[147] 886 P.2d 652 (Colo. 1994).

[148] 894 P.2d 788 (Kan. 1995).

royalty generally and cite royalty case law, they imply, if not hold, that both overriding royalty and lease royalty should be valued on the same basis.[149]

In contrast to *Garman* and *Sternberger*, the Oklahoma Supreme Court, in *XAE Corp. v. SMR Property Management Co.*,[150] specifically held that an in-kind overriding royalty interest allows the lessee to deliver the royalty gas to the overriding royalty owners in its natural condition at the wellhead, therefore costs associated with processing that gas to make it marketable are deductible.[151] Although there are certainly factual differences between the cases and the royalty provisions, the Oklahoma Supreme Court spent a substantial portion of the opinion discussing what right, if any, overriding royalty owners had to rely on the implied covenant to market. In apparent reliance on Professor Kuntz's comment that, as a general proposition, overriding royalty owners should not be able to avail themselves of implied covenants, the court held that an operator owes no duty to market to overriding royalty owners, therefore the marketable condition rule was inapplicable.[152] In his most recent article on this subject, Professor Owen Anderson soundly criticizes the Oklahoma Court's distinction between royalty and overriding royalty in this context as well as its total failure to consider the actual language of the royalty clause in allowing the deduction of processing costs.[153]

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[149] *Garman*, 886 P.2d 652; *Sternberger*, 894 P.2d 788. Texas and New Mexico also appear to treat royalty and overriding royalty interests alike in royalty valuations issues. *See* Danciger Oil & Refineries, Inc. v. Hamill Drilling Co., 171 S.W.2d 321 (Tex. 1943); Martin v. Glass, 571 F. Supp. 1406 (N.D. Tex. 1983); Creson v. Amoco Prod. Co., 10 P.3d 853 (N.M. Ct. App. 2000).

[150] 968 P.2d 1201 (Okla. 1968).

[151] *XAE*, 968 P.2d at 1208.

[152] *Id.* at 1207.

[153] Owen L. Anderson, *Royalty Valuation: Should Overriding Royalty Interests and Nonparticipating Royalty Interests, Whether Payable in Value or in Kind, Be Subject to the Same Valuation Standard as Lease Royalty?*, 35 LAND & WATER L. REV. 1, 6 (1999). The royalty provision in *XAE Corp.* expressly provided for the payment to be based on all gas "which may be produced . . . the same to be delivered . . . free and clear of all costs and expenses whatsoever, save and except gross production taxes and other government taxes . . . ." *XAE*, 968 P.2d at 1202.

The distinctions between an overriding royalty, mineral royalty and severed non-participating royalty also seemed to have little relevance to the issue of deductibility of post-production costs. Overriding royalty and severed non-participating royalties are generally created by assignments, not oil and gas leases. However, an overriding royalty, by its very nature, must be subject to an existing oil and gas lease and most non-participating royalties are also so specified being expressly subject to existing or future leases. Perhaps even more important is that assignments of overriding royalty or non-participating royalty will generally have express royalty obligations which either reference an existing lease or will track the typical lease royalty provision.

While "overriding royalty is often phrased as being payable in-kind," in practice it is most often paid in value.[154] Further, creations of overriding royalty interests most often are made between sophisticated parties aware of industry custom and practice. Therefore, greater reliance can and should be placed on the actual contract language with respect to royalty valuation issues. This distinction at best should favor treatment of overriding royalty under the plain terms of the transaction rather than under the implied covenant to market. However, the same arguments favoring the requirement that oil or gas be in its marketable condition before the royalty obligation occurs is equally applicable to an overriding royalty or severed non-participating royalty interest.

Professor Anderson makes one other argument in favor of having no distinction between the type of royalty in connection with these royalty valuation issues.

> Perhaps the most compelling reason for a single royalty valuation approach is to establish, to the extent possible, a uniform regime for royalty remittance and valuation. The oil and gas industry is facing an ever-growing problem of fractionalization and subdivision of mineral interests. This proliferation of small fractional mineral interests and various resulting types of royalty interests is already requiring companies to maintain and administer, at great expense, exten-

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[154] *See* Anderson, *supra* note 153, at 17.

sive and complex division order records, something the industry does not face in overseas operations. Achieving a uniform regime of royalty valuation law, preferably nation-wide, for all royalty interests would lower lease and division order maintenance and administration costs for the entire oil and gas industry.[155]

V. Deductibility of Costs By Operation

A. Transportation and Gathering

For purposes of this article, transportation costs will be deemed as those costs necessary to transport oil and gas production from the wellhead to the first purchaser's pipeline, or designated delivery point on a pipeline.[156] Many times part of the transportation cost from the wellhead to the purchase delivery point includes "gathering costs." Gathering costs traditionally will be the cost to collect gas from various wells in a field through smaller diameter lines to a central collection point.[157] From there, the gas is, when necessary, processed,

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[155] *Id.* at 19 (footnote omitted).

[156] In today's deregulated and restructured natural gas pipeline system, quite often the purchaser is not a pipeline at all. Rather it is often some third party who has agreed to accept delivery of the gas at a delivery point on a transporter's pipeline and to absorb subsequent transportation costs as part of the negotiated purchase price.

[157] The distinction between a gathering line and a pipe line was litigated heavily in the days of Natural Gas Act jurisdiction over first sales. Prior to the enactment of the Natural Gas Policy Act of 1978 and the deregulation of first sales of gas, gathering lines were generally deemed to be those lines from the wellhead to some processing plant, the tailgate of which was the point of delivery to interstate commerce. *Compare* Brooks Gas Corp. v. FPC, 383 F.2d 503 (D.C. Cir. 1967), *and* McCulloch Interstate Gas Corp. v. FPC, 536 F.2d 910 (10th Cir. 1976), *with* Ben Bolt Gathering Co. v. FPC, 323 F.2d 610 (5th Cir. 1963), *and* Deep S. Oil Co. v. FPC, 247 F.2d 882 (5th Cir. 1957). Since that time the Federal Energy Regulatory Commission (FERC) has adopted the "primary function" test first announced in *Farmland Indus., Inc.*, 23 F.E.R.C. ¶ 61,063 (1983), and looks at the primary function of the facility in order to classify it as transportation (still regulated by the FERC) or gathering (unregulated). *Id.* at 61,143. The factors to be judged include the following:

(1) The diameter and length of the facility,
(2) The location of compressors and processing plants,
(3) The extension of the facility beyond the central point in the field,

refined, compressed, dehydrated or just transported to market.[158]

Courts in the "plain terms" or "property" jurisdictions generally hold that transportation and gathering costs to a purchaser's pipeline, whether on or off a lease, are post-production costs which may be shared with a lessor through a deduction from the value of production.[159] This presumes that the royalty clause provides for computation "at the well" and the sale occurs off-premises at the point of delivery to the purchaser or transporter. The implied covenant to market does not create a duty for the lessee to transport production to markets off the lease when no market exists for the production at the well.

Other courts, predominantly in "cooperative venture" jurisdictions, have held that the lessee may deduct the cost of transporting gas to an off-lease purchaser from the value of production when no market exists for the gas at the well. Even then, a lessee may only deduct the actual cost, not more than is reasonable, to transport the gas from the lease.

States which have expressly adopted the "marketable con-

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(4) The location of wells along or part of the facility, and

(5) The geographical configuration of the system.

Northwest Pipeline Corp. v. FERC, 905 F.2d 1403, 1408 (10th Cir. 1990). Under this primary function test, courts have been much more willing to designate fieldwide pipe line systems as gathering systems. *Id.* at 1412; EP Operating Co. v. FERC, 876 F.2d 46 (5th Cir. 1989).

[158] Whether or not gathering or transportation costs are incurred before or after gas is processed is a significant fact in those states which follow the "marketable condition" rule.

[159] *See* Piney Woods Country Life Sch. v. Shell Oil Co., 726 F.2d 225 (5th Cir. 1984) (applying Mississippi law) (both "amount realized computed at the well" and "market value at the well" leases provide for deductibility of reasonable processing, transportation and fuel costs); Wall v. United Gas Pub. Serv. Co., 152 So. 561 (La. 1934) (transportation and refining costs deductible for "market price" leases); Heritage Res., Inc. v. NationsBank, 939 S.W.2d 118 (Tex. 1996) (transportation and treatment costs deductible under "market price at the well" lease); *see also* Schroeder v. Terra Energy, Ltd., 565 N.W.2d 887 (Mich. Ct. App. 1997) ("gross proceeds at the wellhead," costs "associated with making natural gas marketable after the gas is severed or removed from the ground" is deductible); Creson v. Amoco Prod. Co., 10 P.3d 853 (N.M. Ct. App. 2000) (gathering, compression and dehydration costs are deductible under a "net proceeds at the well" lease).

dition" rule also require proof that the gas is in marketable condition prior to the transportation and that the transportation costs do not cause the lessor to receive less than it would have received had the gas been sold on the lease.[160] Obviously, under the marketable condition rule, states do not consider gathering costs incurred prior to processing non-marketable gas to qualify as deductible transportation expenses.

The two Arkansas cases are classified as such, along with the Oklahoma and Colorado cases, because of Arkansas' decision to follow *Tara Petroleum Corp. v. Hughey*,[161] instead of the *Vela-Middleton* rule with regard to the calculation of market value.[162] In *Clear Creek Oil and Gas Co.*, the Arkansas Supreme Court did calculate a royalty value of "market price of royalty gas at the well" based on what the lessee actually received for the gas less actual transportation costs rather than following comparable sales in the same field that would have resulted in a smaller royalty to the lessor.[163] However, in nei-

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[160] Sternberger v. Marathon Oil Co., 894 P.2d 788 (Kan. 1995) (holding amortized construction and operating costs of pipeline for marketable gas was deductible under "market price at the well" lease). The Kansas court specifically noted that there was no "activity designed to enhance the product, such as compression, processing, or dehydration" involved in this case. *Sternberger*, 894 P.2d at 799; *see* XAE Corp. v. SMR Prop. Mgmt. Co., 968 P.2d 1201 (Okla. 1998) (holding gathering and processing costs deductible and marketable condition rule not applicable); Mittelstaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203 (Okla. 1998) (gathering costs deductible if they enhance value of already marketable product, are reasonable and are proportionate to increase in value of revenue); TXO Prod. Corp. v. Comm'rs of the Land Office, 903 P.2d 259 (Okla. 1994) (gathering costs not deductible as a matter of law); *see also* Parnell, Inc. v. Giller, 372 S.W.2d 627 (Ark. 1963) (costs to transport salt water in marketable condition off-lease are deductible); Clear Creek Oil & Gas Co. v. Bushmiaer, 264 S.W. 830 (Ark. 1924) (allowing deduction only for actual costs incurred for transportation from off-lease sales price); Garman v. Conoco, Inc., 886 P.2d 652 (Colo. 1994) (transportation expenses deductible only to extent reasonable and proportionate to increase in revenues of production already in marketable condition); Rogers v. Westerman Farm Co., 986 P.2d 967 (Colo. Ct. App. 1998) (cost to gather, dehydrate and compress gas into pipeline deductible since gas in marketable condition at wellhead).

[161] 630 P.2d at 1269.

[162] Hillard v. Stephens, 637 S.W.2d 581, 584 (Ark. 1982).

[163] *Clear Creek*, 264 S.W. at 832. Without expressly stating it, the court seems to imply that the lessee must share its market, less actual post-production costs, especially where that market provides for a net price in excess of market price at

ther *Clear Creek* nor *Parnell* did the Arkansas Supreme Court indicate if it will apply the marketable condition rule.

Wyoming has taken a different tact in dealing with this issue. In *Wold v. Hunt Oil Co.*,[164] the court determined that Wyoming's Royalty Payment Act had essentially pre-empted the common law determination of contractual royalty obligations and held that "the statutory definition of 'cost of production' excludes all charges between the wellhead and the market pipeline except those specifically excluded from the definition."[165] Under Wyoming's Royalty Payment Act, gathering, compressing, dehydrating and transporting gas into the market pipeline are all specifically defined as "costs of production."[166] Transportation of gas "from the point of entry into the market pipeline [downstream] or the processing of gas in a processing plant" are specifically excluded from costs of production.[167]

B. Compression

For purposes of this article, compression costs are those costs utilized to increase pressure necessary to allow natural gas to move within a gathering or transportation system to the point of first sale. Traditionally, gas must be pushed at a pressure equal to or exceeding the existing line pressure at the point of delivery. This type of compression should be distinguished from a producer's use of the same equipment to either obtain production in a very low pressure reservoir or to increase the rate of production into what would be otherwise deliverable pressure conditions.[168]

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the well. *Id.*

[164] 52 F. Supp. 2d 1330 (D. Wyo. 1999).

[165] *Wold*, 52 F. Supp. 2d at 1336. The court questioned the Colorado Supreme Court's characterization in *Garman* that Wyoming had codified the marketable condition rule. *Id.* It emphasized that the Royalty Payment Act is "unique" and should be interpreted without regard to "common law as it [has] evolved in other states." *Id.*

[166] *See* WYO. STAT. ANN. § 30-5-304(a)(vi).

[167] *Wold*, 52 F. Supp. 2d at 1332. Nevada has a similar statutory scheme. NEV. REV. STAT. ANN. § 522.115 (Michie 1995).

[168] The use of compressors to "suck" gas from a low pressure reservoir or to increase production rates would generally be considered production-related expens-

Courts in the "plain terms" or "property" jurisdictions generally hold that compression costs required to move gas into a producer's pipeline may be deducted from the value of the production, as long as the delivery point is not located on premises.[169]

In states which follow the "marketable condition" rule, compression costs may not be deducted prior to the lessee's demonstration that a marketable product exists. If the lessee can show that a marketable product exists, reasonable cost of compression may be deducted if proportional to the increase in revenues resulting from such services.[170] None of the cases in

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es and the sole obligation of the working interest owners. Gilmore v. Superior Oil Co., 388 P.2d 602 (Kan. 1964).

[169] *See* Martin v. Glass, 571 F. Supp. 1406 (N.D. Tex. 1983), *aff'd* 736 F.2d 1524 (5th Cir. 1984) (finding no market existed absent compression and thus distance between potential market and wellhead is immaterial under "net proceeds at the well" lease); Skaggs v. Heard, 172 F. Supp. 813, 815 (S.D. Tex. 1959) (holding that "at the well," when construed in light of other lease provisions and parties' conduct, meant on the leased premises, therefore on-lease compression costs not deductible); Merritt v. Southwestern Elec. Power Co., 499 So. 2d 210 (La. Ct. App. 1986) (compression costs deductible under "market value at the well" leases); *see also* Creson v. Amoco Prod. Co., 10 P.3d 853 (N.M. App. 2000) (gathering, compression and dehydration deductible under net proceeds "at the well"); Judice v. Mewbourne Oil Co., 939 S.W.2d 133 (Tex. 1996) (stating that although compression costs are normally deductible, where some division orders required payment of "gross proceeds realized at the well" they are not); Parker v. TXO Prod. Corp., 716 S.W.2d 644 (Tex. App. 1986), *no writ* (finding compression primarily used to increase production is not deductible). "At the well" is construed in Texas to mean anywhere on the leased premises. Therefore, delivery of gas on the lease would be a sale at the well and not subject to deduction of expenses. *Skaggs* was severely distinguished and all but overruled in *Martin*, 571 F. Supp. 1406, *aff'd* 736 F.2d 1524 (5th Cir. 1984). It should, therefore, be limited to its facts, specifically the fact that the sale of gas was construed to have occurred "at the well" as such no net back of post-production expenses is possible under the typical royalty clause.

[170] *See* Harding v. Cameron, 220 F. Supp. 466 (W.D. Okla. 1963) (under value or prevailing market rate at the well, court found lack of market existed which required compression, therefore deductible); Mittelstaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203 (Okla. 1998) (stating compression costs deductible if they enhance value of already marketable product, are reasonable and are proportionate to increased revenues); TXO Prod. Corp. v. Comm'rs of the Land Office, 903 P.2d 259 (Okla. 1994) (royalty "without cost into pipelines," compression, dehydration and gathering costs necessary to make gas market, therefore not deductible); Wood v. TXO Prod. Corp., 854 P.2d 880 (Okla. 1992) (distinguishing *Harding* and adopting duty to market rule, holding that, absent express agreement, compres-

"market condition" jurisdictions have expressly dealt with compression costs necessary to gather natural gas into a processing plant. Presumably, the deductibility of such costs would turn on whether or not a reviewing court would consider such gas to be "marketable" at the well.

C. Processing / Dehydration / Refining

All of these operations involve changing the chemical composition of the oil or gas stream once it leaves the wellhead. However, for purposes of this article these terms will be separated into more discreet operations. As used in this article, "processing" shall mean any process designed to remove unmarketable elements or compounds (hydrocarbon and non-hydrocarbon) from oil and gas, including absorption, adsorption, or refrigeration. Mechanical separating processes which normally take place on or near the lease will not be considered processing.[171] "Dehydration" shall mean the removal of water from gas and fluid produced from oil wells.[172] This process normally begins at the heater/treater, on lease, but can also be an aspect of processing or a separate part of a gathering system, such as a glycol dehydrator designed to eliminate moisture still

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sion costs not deductible); *see also* Hanna Oil & Gas Co. v. Taylor, 759 S.W.2d 563 (Ark. 1988) (holding "proceeds received at the well" to mean compression costs not deductible absent some reference to cost or "net" proceeds); Garman v. Conoco, Inc., 886 P.2d 652 (Colo. 1984) (finding compression costs deductible only to extent they enhance value of product already in marketable condition, are reasonable, and are proportionate to increase in value); Rogers v. Westerman Farm Co., 986 P.2d 967 (Colo. App. 1998) (specifically discussing the point of marketability and indicating costs must be related to transmission of gas off-lease); XAE Corp. v. SMR Prop. Mgmt. Co., 968 P.2d 1201 (Okla. 1998) (holding marketable condition rule not applicable to overriding royalty payable in kind, therefore gathering and processing costs deductible).

The Colorado Supreme Court in *Garman*, responding to certified questions from the federal court, intentionally did not address the specific royalty language in the assignment at issue and simply applied the "general principles of Colorado law to the issue[s]. *Garman*, 886 P.2d at 654. Subsequent cases in plain meaning jurisdictions have expressed considerable dissatisfaction with the apparent abandonment or irrelevance of contract construction. *See, e.g.*, Heritage Res., Inc. v. NationsBank, 939 S.W.2d 118, 127-28 (Tex. 1996).

[171] WILLIAMS & MEYERS, *supra* note 12, at 831 (quoting 30 C.F.R. §§ 206.101, 206.151 (1991)).

[172] *Id.* at 260.

in the system after field separation.[173] "Refining" shall mean the operation by which the physical or chemical characteristics of the produced oil and gas are changed into separate refined petroleum or gas products capable of being separately marketed from the refinery.[174] In most cases, refining is involved with oil products. However, "wet gas" streams are often refined to remove liquid natural gas and other light distillates.[175] The difference between processing and refining is one of degree and purpose. Where the primary purpose of the operation is to remove contaminants from production prior to sale, one should deem that to be processing. Where the primary purpose is to separate production into separate marketable constituent products, one should deem that to be refining. In most cases, processing or refining operations have a little of both.[176]

"Plain terms" and "property" jurisdictions have all held that reasonable processing, refining and dehydration costs incurred by a lessee to increase the value of gas prior to market or to place the gas into a condition suitable for the purchaser's pipeline are all post-production costs and may be deducted for royalty purposes.[177] Note that in these jurisdic-

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[173] *Id.* at 463.

[174] *Id* at 903.

[175] *Id.* at 1181.

[176] For example, in *Piney Woods*, the primary purpose of the processing by Shell was to remove H_2S and other impurities from the gas in order to make it marketable. *Piney Woods*, 726 F.2d 225 (5th Cir. 1984). However, the processing byproduct was the sale of substantial amounts of sulfur as a marketable refined product produced from the operation. *Id.* at 229.

[177] *See* Freeland v. Sun Oil Co., 277 F.2d 154 (5th Cir. 1960) (refining costs deductible under market value at the well lease); Babin v. First Energy Corp., 693 So. 2d 813 (La. App. 1997) (applying rule that processing costs must be reasonable and not in excess of lessee's actual costs); Wall v. United Gas Pub. Serv. Co., 152 So. 561 (La. 1934) (transportation and refining costs deductible under "market price" lease); Heritage Res., Inc. v. NationsBank, 939 S.W.2d 118 (Tex. 1997) ("royalty is usually subject to post-production costs, including taxes, treatment costs to render it marketable, and transportation costs"); *see also Piney Woods*, 726 F.2d 225 (holding under both amount realized and market value leases, reasonable processing, transportation and fuel costs are deductible); Old Kent Bank & Trust Co. v. Amoco Prod. Co., 679 F. Supp. 1435 (W.D. Mich. 1988) (processing costs are deductible under "gross proceeds received from the sale thereof at the mouth of the well" lease); Schroeder v. Terra Energy, Ltd., 565 N.W.2d 887 (Mich. Ct. App. 1997) (holding any costs associated with making

tions, only intermediate appeals courts and federal courts have specifically held that the cost of processing non-marketable gas is deductible. The Supreme Courts in Texas, Louisiana, Michigan, New Mexico and Mississippi have yet to expressly address what, if any, bearing the "marketable condition" of gas has on the deductibility of post-production costs from royalty.[178]

States that have adopted the marketable condition rule have generally held that the cost of processing, treatment and dehydration necessary to create a marketable product must be born solely by the lessee.[179] However, the reasonable cost of any dehydration, treatment, or refining which increases the value of the already marketable oil and gas may be deducted where the costs are deemed reasonable and are proportionate to the increase in value to the gas of the operation.[180]

The problem with determining what operations are necessary to make gas "marketable" are demonstrated by two opposing positions taken on dehydrating costs. In *TXO*, the Oklaho-

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natural gas marketable after the gas is severed or removed from ground are deductible under "gross proceeds at the wellhead" lease); Creson v. Amoco Prod. Co., 10 P.3d 853 (N.M. App. 2000) (gathering, compression and dehydration deductible under "net proceeds at the well" lease); Danciger Oil & Refineries, Inc. v. Hamill Drilling Co., 171 S.W.2d 321 (Tex. 1943) (stating that royalty should be paid on value of production rather than proceeds from refined petroleum products).

The one exception would be where the alleged operation is part of the generally recognized field separation operations that naturally occur on lease immediately after the well head to separate oil, gas and produced water.

[178] California, "a jurisdiction where the oil and gas industry has developed somewhat unique customs, practices, and lease forms," has long established that the royalty obligation is determined by net back to the wellhead whether or not the oil or gas was marketable at that point. Anderson, *supra* note 35, at 655-61. For a discussion of California cases beginning in 1935, see *id.*

[179] *See* XAE Corp. v. SMR Prop. Mgmt. Co., 968 P.2d 1201 (Okla. 1998) (processing costs deductible to overriding royalty payable in kind); TXO Prod. Corp. v. Comm'rs of the Land Office, 903 P.2d 259 (Okla. 1994) (royalty "without cost into pipelines," dehydration, compression and gathering costs deemed necessary to prepare production gas for pipeline and may not be deducted).

[180] *See* Rogers v. Westerman Farm Co., 986 P.2d 967 (Colo. Ct. App. 1998) (dehydration and compression were deductible because gas was "sweet and dry" at "mouth of the well"); Mittelstaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203 (Okla. 1998) (dehydration and blending costs deductible only if lessee can demonstrate oil or gas already marketable, costs are reasonable and in proportion to increase in value of operation).

ma Supreme Court stated:

> According to TXO's brief in chief, dehydration "involves removal of moisture from gas before it enter's [sic] the purchaser's pipeline." Such a process is necessary in order to make the product marketable and involve[s] costs incident to delivering the product into pipelines. As such, costs of dehydration are not chargeable against Commissioners under *Wood*.[181]

In *Rogers*, the Colorado Supreme Court stated:

> It is undisputed that the dehydration and compression demanded by this amended agreement were not required to remove any impurities from the gas. Rather, the dehydration was required so that the gas would not cause undue deterioration to the interstate pipeline, and it was required to be compressed because, as a result of the pressure of the gas in that pipeline, gas having a lower pressure could not enter it.[182]

Notwithstanding the different royalty provisions at issue in these two cases, there is no reasonable distinction that can be made between holding dehydration and compression in *TXO* to be necessary to make the gas marketable (and non-deductible) and holding those same costs in *Rogers* to be deductible because the gas was "sweet and dry" (marketable) at the wellhead.

D. Fuel Use/Saltwater Disposal

These operations are discussed together because they are traditionally production-related expenses. Operators traditionally use natural gas produced from a well to operate the production surface facilities and, where necessary, compressors to get the gas to market. Where the gas is "used on premises" there is no obligation under the typical royalty provision to pay

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[181] *TXO*, 903 P.2d at 262.

[182] *Rogers*, 986 P.2d at 969-70.

royalty for that gas so used. However, where the natural gas is used off premises, a royalty obligation does accrue notwithstanding the fact that the operator is using the gas for its own operations.

The only opinion to directly address the deductibility of fuel use off lease is *Piney Woods Country Life School v. Shell Oil Co.*[183] in which the Fifth Circuit, applying Mississippi law, specifically dealt with the question of whether or not gas used by Shell for its operations on other leases and the plant was subject to royalty payments.[184] Shell contended that no accounting was necessary because the royalty due on gas sent to the plant and then used for post-production operations was washed by the deductible expense.[185] The Fifth Circuit disagreed:

> Even if Shell is right that it owes no extra royalties for plant fuel, we do not think that this would justify its practice. The lessors are entitled to have their royalty determined according to the provisions of the lease, not according to an ad hoc method adopted without their consent. The leases plainly call for market value royalty on gas used off the lease and the royalty should be determined on that basis. We therefore hold that plant fuel is gas used off the lease and the lessors are entitled to market value royalty on that gas. Shell may, however, treat the royalty payments as processing costs to be divided, as any other processing costs, among the various working and royalty interests.[186]

Thus, all gas sent off lease, regardless of how used, must be accounted for to the royalty owners, even if that gas is ultimately used as a deductible expense. However, the deductibility of the use of that gas must then be separately determined under the provisions of the leases. For example, in a market-

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[183] 726 F.2d at 225. This case went from the trial court to the Fifth Circuit and back again three times over a span of twenty years and was recently concluded in a final judgment by the Federal District Court in Jackson, Mississippi, without further appeal by either side.

[184] *Piney Woods*, 726 F.2d at 241.

[185] *Id.*

[186] *Id.*

able condition jurisdiction, gas that is used by the operator in a processing plant to make gas marketable would arguably still be subject to the royalty obligation and not deductible as an expense.[187] In reality, the cost of fuel related to the operation would probably be deductible or not depending on the nature of the operation. For example, fuel use related to compressor costs would be deductible provided the operation of the compressor is a deductible cost.[188]

Disposal of salt water is another typical production-related function, where a well produces quantifiable amounts of water. Typically the water is separated on-lease at the heater treater and then is carried by pipe to a salt water disposal well or trucked to a nearby commercial salt water disposal well. However, where oil and gas is gathered from a number of wells to a central point and is subsequently processed or dehydrated, disposal of the water extracted from the process is a cost subject to the deductibility issue.

The only reported case found which expressly deals with the deductibility of water disposal operations is the Arkansas case of *Parnell, Inc. v. Giller*,[189] where the court held the cost of disposing salt water shipped to and used by the chemical company purchaser in its plant to be deductible.[190] The court stated:

> As a transportation cost the pipeline expense falls within the letter of the Bushmaier [sic] case. The expense of disposing of the used brine falls within its reasoning. Both services were demanded by the chemical company [purchaser] as a condition to its willingness to enter into the contract of purchase. It is not reasonable to suppose that the buyer would have agreed to pay as much as it did for the brine if the performance of these necessary steps had been its own responsibility. Hence, as in the Bushmaier [sic] case, these charges must

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[187] The author is unaware of any case in a market condition jurisdiction specifically dealing with this issue.

[188] For another case discussing "fuel use," see *Matzen v. Hugoton Prod. Co.*, 321 P.2d 576, 584-85 (Kan. 1958) (finding lease fuel and shrinkage at processing plant deductible).

[189] 372 S.W.2d 627 (Ark. 1963).

[190] *Parnell*, 372 S.W.2d at 628.

> be taken into account in fixing the market value at the well.[191]

Although this case is easily distinguishable from disposal of water extracted from gas or related to processing plant, it is arguably persuasive in support of the disposal of salt water being a necessary incident to off-lease operations. Where, however, salt water is disposed of after its separation from produced hydrocarbons, this disposal is generally regarded as a production expense that the working interest owners alone bear.[192]

E. Cost of Money / Rate-of-Return / Depreciation

These "soft costs" and risk-rewards for capital improvements can be expensed or amortized and depreciated by the working interest owners, because under generally accepted accounting principles, any time improvements are constructed. The question is: are these accounting expenses deductible from royalty payments when related to the construction of improvements used solely in post-production operations?

For purposes of this article "cost of money" shall be the interest charged by a lender to an operator to construct and own the post-production facilities at issue. Where the operator uses its own funds to build and own such facilities, "cost of money" would be the prevailing interest rate for the use of that money until paid back. "Depreciation" shall mean the accepted accounting method of amortizing the cost of capital improvement over the recognized life of the improvement. Finally, "rate of return" shall mean the profit the operator would receive for risking its capital or lending powers to the construction of this facility.

This issue was treated extensively by Professor Owen Anderson in the first of his five major papers on this subject.[193]

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[191] *Id.* at 628.

[192] Anderson, *supra* note 153, at 6.

[193] Owen L. Anderson, *Calculating Royalty: "Costs" Subsequent to Production – "Figures don't lie, but . . . ,"* 33 WASHBURN L.J. 591 (1994).

Without attempting to summarize the discussion points raised by Professor Anderson in his lengthy article, his conclusion is as follows:

> In order to obtain a market, the lessee is not obligated to invest in post-production facilities at its own expense unless the lessee is able to make a reasonable profit. However, to avoid overreaching by the lessee in the calculation of royalty payments, the lessee may deduct only reasonable and necessary direct costs, not to exceed actual costs, and in no case should a lessee be allowed to "zero out" the wellhead value of gas. In other words, the lessor must receive a reasonable royalty on marketed gas measured in the context that royalty is part of the consideration for the lease. In assuring the lessor of a reasonable royalty, all profit from a post-production facility must be derived from the lessee's working interest share, and not from the lessor's royalty share. Thus, a return on investment "cost" should be eliminated from the work-back royalty calculation or – at the very least – be limited to a cost-of-money charge, such as the prime rate of interest.[194]

According to Professor Anderson's article, six oil and gas cases addressed or, in dicta, discussed the operator's right to receive a fair rate of return on post-production capital improvements.[195] In only one, *Piney Woods Country Life School v. Shell Oil Co.*,[196] did the court approve, as reasonable, a work-back formula giving the operator a 15% rate of return after

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[194] *Id.* at 637.

[195] For a discussion of *Scott Paper Co. v. Taslug, Inc.*, 638 F.2d 790 (5th Cir. 1981), *Phillips Petroleum Co. v. Johnson*, 155 F.2d 185 (5th Cir. 1946), *Matzen v. Hugoton Prod. Co.*, 321 P.2d 576 (Kan. 1958) and *Locke v. Russell*, 84 S.E. 948 (W. Va. 1915), see *id.* at 606-17. Anderson concludes that all of these cases either never discussed the deductibility of these soft costs or that such discussion was dicta. *Id.* at 607.

[196] Unpublished Mem. Op. and Order, 29-30 (S.D. Miss., April 24, 1989), on remand from 726 F.2d 225 (5th Cir. 1984).

taxes on gathering and processing facilities. In *Harding v. Cameron*,[197] a case not discussed by Anderson, a federal district court in Oklahoma, in dicta, commented that Oklahoma law allowed reasonable depreciation of a compression plant construction cost to be deducted from royalties based on market price at the well.[198] In both Arkansas and Louisiana, there are holdings to the effect that, although lessees are allowed to deduct for reasonable costs, they are not entitled to make a "profit" on the sale of royalty gas.[199]

Since Professor Anderson's 1994 article, cases have indicated approval of the deduction of some of these soft costs where the operations to which costs were applied, were found to be deductible.[200]

In 1999, Professor Anderson decided to revisit the issue of what specific costs could be chargeable against royalty owners within the "marketable condition jurisdictions."[201] He concluded that, because lessees bear the increased burden of making gas marketable, the types of costs recoverable on post-marketable, post-production expenses should be somewhat more relaxed, stating:

What then is the bottom line? As in a wellhead-value jurisdic-

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[197] 220 F. Supp. 466 (W.D. Okla. 1963).

[198] *Harding*, 220 F. Supp. at 470. The court cited the cases discussed by Anderson. *See id.* at 470-73.

[199] *See* Babin v. First Energy Corp., 693 So. 2d 813, 816 (La. App. 1997); Clear Creek Oil & Gas Co. v. Bushmiaer, 264 S.W. 830, 832 (Ark. 1924).

[200] *See* Atl. Richfield Co. v. Farm Credit Bank, 226 F.3d 1138, 1153-56 (10th Cir. 2000) (applying Colorado law, lessee's cost of money to construct and own pipeline were transportation costs and thus deductible unless lease provided otherwise; lessee's depreciation deduction could not be based on capital expenditures of third party to which lessee had conveyed 50% interest); Sternberger v. Marathon Oil Co., 894 P.2d 788 (Kan. 1995) (approving "line amortization charge" to recover 12% of entire cost of constructing and maintaining pipeline from royalty owners); Creson v. Amoco Prod. Co., 10 P.3d 853, 860 (N.M. Ct. App. 2000) ("[D]eductions for depreciation of capital investments may be proper if those capital expenditures related to enhancing the value of the gas after it reached the wellhead in a marketable state."). The Tenth Circuit did not reject the deductibility of ARCO's depreciation deduction, only Arco's attempt to claim a depreciation deduction for a third party's expenditures (85% of the capital to build the pipeline). *Atl. Richfield*, 226 F.3d at 1149-1169.

[201] Owen L. Anderson, *Royalty Valuation: Calculating Freight in a Marketable-Product Jurisdiction*, 20 ENERGY & MIN. L. FOUND. § 10.02 (1999).

tion, "costs" should not include a profit rate of return, either before or after income taxes, in a marketable-product jurisdiction. I would, however, allow a cost of money charge in a marketable product jurisdiction and to allow other reasonable indirect costs, such as overhead. I remain critical of the statements in Garman and Mittelstaedt, suggesting that a lessee might be obliged to share downstream net profits with a lessor where the lessee sells the gas beyond the first market. However, if a duty to share profits turns out to be the "law," I would still not permit a lessee to claim a profit rate of return, before or after income taxes, when computing downstream costs because such a calculation would seemingly contradict these very statements. However, I would permit the lessee a full recovery of downstream costs even if such costs reduced the value of gas to at or near zero due to general market conditions. If lessors are entitled to share downstream profits, they should also share, through royalty accounting, in downstream risks incurred by a reasonable and prudent operator.[202]

F. Marketing Fees / Overhead

Many large companies, majors and independents alike, now have separate gas marketing departments whose responsibility is to market gas once produced for the best possible terms and price. Separate marketing companies have also sprung up to offer their services, for a fee, to oil and gas working interest owners who desire to separately sell their gas.[203] The question, therefore, occurs as to whether or not these expenses, either in the form of marketing fees paid to a separate marketer, or marketing department overhead can be deducted from royalty.

To date no case has directly addressed this issue, although

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[202] *Id.*

[203] Some state statutory schemes now recognize that marketing fees are appropriate post-production costs. For example, under Mississippi's Natural Gas Marketing Act, the operator of a well is entitled to charge to any non-operator a "marketing fee in the amount equal to two and one-half percent (2 1/2%) of Consenting Non-operator's monthly net proceeds . . . ." MISS. CODE ANN. § 75-58-11 (2000).

certainly such costs may be imbedded in "transportation charges" held to be deductible in many jurisdictions. In *Schroeder v. Terra Energy, Ltd.*,[204] the Michigan Court of Appeals held that costs incurred in "transporting, treating, and marketing" were deductible from royalties payable on "gross proceeds at the wellhead."[205] However, there is nothing in this case that indicates what those "marketing costs" were.

Professor Anderson would allow the deduction of these costs, once gas is marketable, in a marketable-condition jurisdiction.[206] Regardless of whether one is in a "plain terms" or "marketable condition" jurisdiction, there is no logical rationale that would justify the exclusion of such costs. These types of costs are directed solely at marketing the gas and are unrelated to making the gas marketable. As long as such costs are "actual" and "reasonable," they should be deductible.

G. Production Taxes

Although the production tax is a cost generally incurred at the time of production, it is also a cost that is generally deducted from the royalty, whether by contract or by state law. Many leases or overriding royalty assignments will specifically allow for the deduction of production or severance taxes. Moreover, most state production or severance tax statutes tax the "owner" of the production, not just the operator or working interest owner. Most of these states have held that royalty owners are "owners" under the statutory scheme and are obligated to bear their proportionate share.[207] More recently, in *Heritage Resources, Inc. v. NationsBank*,[208] the Texas Supreme Court, in dicta, acknowledged that "royalty is usually subject to post-

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[204] 565 N.E.2d 887 (Mich. App. 1997).

[205] *Schroeder*, 565 N.W.2d at 884.

[206] Anderson, *supra* note 202, § 10.02.

[207] *See* Holbein v. Austral Oil Co., 609 F.2d 206 (5th Cir. 1980); Sartor v. United Gas Pub. Serv. Co., 173 So. 193 (La. 1937); Gulf Ref. Co. v. Stone, 21 So. 2d 19 (Miss. 1945); Canadian River Gas Co. v. Bivins, 153 S.W.2d 432 (Tex. 1941). If the lease specifically provides that royalties are to be paid free of any tax deduction, courts have given such language effect. *Compare* Tenneco West, Inc. v. Marathon Oil Co., 756 F.2d 769 (10th Cir. 1985), *with* J. M. Huber Corp. v. Santa Fe Energy Res., Inc., 871 S.W.2d 842 (Tex. App. 1994).

[208] 939 S.W.2d 118 (Tex. 1996).

production costs, including *taxes*, treatment costs to render it marketable, and transportation costs."[209]

VI. Attempts to Specifically Include/Exclude Post-Production Costs

It is now rather common for leases, especially from professional mineral owners, to have typed provisions which are intended to override or supplement the form royalty provisions. This can also occur in the form of a subsequent amendment to the lease executed by both parties. Further, as is often the case, the parties do not anticipate either the potential or the types of post-production expenses that can occur at the time the lease is executed. However, when production is achieved, the lessee realizes that significant post-production expenses are going to take place and may chose to either create or clarify the deductibility of such charges through a "division order."

A. Lease Addendum or Amendment

The actual language of a lease addendum or amendment must be carefully reviewed with the form royalty provision to determine the intent and effect. Obviously, if the addendum begins with the following phrase, "The first two sentences of paragraph 3 [the oil and gas royalty provisions] are hereby deleted and the following inserted in their place," or something similar to it, then attempting to interpret the two separate provisions in para materia is no longer necessary. Often lease addendum provisions begin with the following phrase: "Notwithstanding anything in the lease to the contrary, ..." This beginning phrase certainly would suggest that, in the event of conflict, the addendum would control. However, such addenda often create an ambiguous instrument because one party can claim the two provisions to be in conflic while another party can claim the addendum merely supplements the standard royalty provision.

Additional language in an addendum which merely supplements the printed royalty provision may still allow the deduc-

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[209] *Heritage Res.*, 939 S.W.2d at 122 (emphasis added).

tion of processing or compression costs from an off-lease sale because, under the form royalty provision, the royalty is still computed "at the well." One prime example of such a result is the Texas case of *Heritage Resources*.[210] In a 5-4 decision, the Texas Supreme Court held that an additional, specifically negotiated provision prohibiting the deduction of the cost of any processing, dehydration, compression, or transportation from the "value of lessor's royalty" to be "surplussage" to a form royalty provision.[211] With that holding, the majority of the court allowed the deduction of compression and transportation costs from off-lease sales to arrive at the market value at the wellhead.

Other royalty addenda attempt to shift the point of the royalty obligation away from the wellhead. This can be done by either striking "at the well" or "computed at the well" from the provision itself or by referencing a different point of sale. In interpreting these multiple clauses, most states recognize the general rules of construction that typed or handwritten language will prevail over the printed form language in a lease. The rule of construction that form leases are to be construed against the lessee is generally neutralized where the addendum language has been provided at the insistence of the lessor.

B. Division Order

Division orders began to emerge around the turn of the century when third party purchasers sought instructions and/or protection from the owners of oil and gas interests being sold as crude oil.[212] "Over the years, the nature of selling and marketing production has changed significantly" and frequently, the operator (or some other working interest owner who is responsible for distributing proceeds) will issue division orders to

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[210] *Id.*

[211] *Id.* at 131. The precise provision in the addendum required lessee to pay lessor a fractional share of the "market value at the well" for all gas "provided, however, that there shall be no deductions from the value of Lessor's royalty by reason of any required processing, cost of dehydration, compression, transportation, or other matter to market such gas." *See id.* at 120-21.

[212] Si M. Bondurant, *Royalty Owner Rights Under Division Orders*, 25 TULSA L.J. 571, 572 (1990).

royalty interest owners as the person responsible for distributing proceeds.[213] One scholar has commented:

> There is no unanimity as to precisely what a division order is or how to define one. . . . It [division order] has been described variously as an executed, bi-lateral contract, a unilateral contract, an element of a contract, and not really a contract. The differences in definitions and descriptions stem partially from the fact that there are various types of division orders in existence, and that the relationships of the parties determines the type of division order used. There is no standard division order and the relationship of the parties must always be considered when interpreting these instruments. The courts have not always clearly understood this.[214]

Bondurant asserts there are three basic types of division orders.[215] First is the "standard third-party purchaser division order" in which both the lessor and lessee direct a third party purchaser to assume the responsibility for disbursement of the proceeds directly to the revenue owners.[216] Second is the "indemnity division order" in which the lessee indemnifies the purchaser "for 100% of the production and the lessee assumes the responsibility for disbursing the royalties."[217] The third type of division order is the "lessee/purchaser division order" which is a direction from the royalty owner to the lessee or operator who assumes the responsibility for disbursing proceeds to the royalty owner.[218]

Execution of a third party purchaser division order by a royalty owner will not relieve lessees from payment of royalty

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[213] *Id.*

[214] *Id.* at 572-73.

[215] *Id.* at 574.

[216] *Id.*

[217] Bondurant, *supra* note 212, at 574.

[218] *Id.* at 574-75. Where the operator of the well is not the lessee, but assumes disbursement obligations for production from that well, the division order will often come from that operator, who is neither the purchaser nor the lessee. Arguably, such a division order from a third party operator would be treated in the same form and fashion as the first type of division order defined by Bondurant: the standard third party purchaser division order.

where the operator/purchaser has improperly paid under the terms of the lease.[219] Further, execution of a division order by the royalty owner, either to the purchaser or to the lessee, will not prevent the royalty owner from pursuing the party who received the funds, especially if the lessee has been unjustly enriched.[220] This discussion, however, will concentrate on the situations where the lessor has executed a division order to the lessee once production has been attained under the original lease.

As a general rule, payments made to a royalty owner, pursuant to a division order directed to the lessee, is binding on that royalty owner until the division order is revoked.[221] This is subject to the *Gavenda* exception: an erroneous division order will not be enforced to the extent the funds have not been paid out by the disbursing party to others.[222] We also note that some jurisdictions, like Kansas, will, as a matter of public policy, not recognize division orders which attempt to alter the lease provisions.[223]

The interplay between the lease royalty provision and a division order directed to the lessee is best illustrated by the recent Texas Supreme Court case of *Judice v. Mewborne Oil Co.*[224] To understand this case, one must remember that it was issued the same day as *Heritage Resources*, which affirmed Texas' long-standing rule that royalty is calculated "at the well" and royalty owners are responsible for their proportionate share of post-production expenses.[225] In *Judice*, there were three leases and three corresponding division orders at is-

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[219] *See* Williams v. Baker Exploration Co., 767 S.W.2d 193, 195-96 (Tex. App. 1989).

[220] *See* Dale v. Case, 64 So. 2d 344, 350 (Miss. 1953); Gavenda v. Strata Energy, Inc., 705 S.W.2d 690, 692 (Tex. 1986).

[221] *See* Exxon Corp. v. Middleton, 613 S.W.2d 240, 249-52 (Tex. 1981).

[222] *See supra* note 205 and accompanying text.

[223] *See* Maddox v. Gulf Oil Corp., 567 P.2d 1326, 1328-29 (Kan. 1977).

[224] 939 S.W.2d 133 (Tex. 1996).

[225] *See supra* notes 210-11 and accompanying text. A number of commentators have suggested that these conclusions are flawed. *See, e.g.*, Laura H. Burney, *The Interaction of the Division Order and the Lease Royalty Clause*, 28 ST. MARY'S L.J. 353, 393-99 (1997).

sue.[226] All of the leases provided that royalty would be based on market value at the well.[227] However, the division orders on the different wells stated as follows:

> On the *Judice* No. 1 and No. 2 Wells:
>
> Settlement for gas sold shall be based on the *gross proceeds realized at the well* by you. For gas used off the leases, settlement shall be based on market value at the well.
>
> On the *Judice* No. 3 Well:
>
> Settlement for gas sold shall be based on the *net proceeds realized at the well* by you, [after deducting any costs incurred in compressing, treating, transporting, and/or dehydrating the gas for delivery] . . . .[228]

The court determined that the division orders on the *Judice* No. 1 and No. 2 Wells created ambiguity with regard to the right to deduct post-production compression costs, stating:

> The term "gross proceeds" means that the royalty is to be based on the gross price received by Mewborne. The use of the term "at the well" indicates just the opposite, that the royalty is to be based on its value "at the well." . . . There is an inherent conflict in the use of the two terms that renders the clause ambiguous.[229]

The supreme court, therefore, affirmed the jury findings that the parties intended that the royalties be based on the price received without deduction of compression charges.[230] On the other hand, the supreme court overruled the trial court with respect to its determination on the *Judice* No. 3 Well, stating

> The language in the division order, even in the face of the handwritten deletions, unambiguously provides that royalty is based on net proceeds at the well. "Net proceeds" expressly

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[226] *Judice*, 939 S.W.2d at 125-26.

[227] *Id.*

[228] *Id.* at 135 (emphasis added) (recognizing actual deletions in original lease in brackets).

[229] *Id.*

[230] *Id.* at 136.

> contemplates deductions, and we note once again that "at the well" means before value is added by preparing the gas for market. . . . The handwritten deletions in the division order do not alter the effect of the remaining language.[231]

Although not discussed in the opinion, the lessee had the right to revoke the division orders at issue in *Judice* and to rely on the lease clause alone in deducting future compression costs. However, for purposes of past payments, the Texas Supreme Court treated the division orders in *Judice* as lease addenda or amendments, which can clearly alter the lease royalty obligations.

VII. CONCLUSION

Professor Anderson's plea for a "uniform regime of royalty law" is certainly understandable after wading through this morass of case law and commentator theories. However, it misses the mark. An oil and gas lease is primarily a unique contract between private parties. Their manifested intent should be honored first and foremost by any court called on to settle a dispute.

To honor this cardinal principle in today's environment, oil and gas lawyers must be acutely aware of the following issues in drafting leases, sales contracts, gathering or processing agreements and division orders.

• *IS THE GAS IN MARKETABLE CONDITION WHEN PRODUCED?*

If it is, then any oil and gas producing state should be willing to follow the contract terms. If not, then the legal precedent in the state where the production occurs will be critical in attempting to recoup gathering, compression, dehydration or processing costs.

• *DOES THE SALE OF GAS ACTUALLY OCCUR OFF THE LEASE PREMISES OR PRODUCTION UNIT AND IS THE ROYALTY VALUATION*

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[231] *Id.* at 137.

COMPLETED "AT THE WELL?"

Both of these factors are necessary conditions to be able to deduct post-production costs. If there are comparable sales by other owners occurring at the same well, those sales may be the basis for royalty based on "market value at the well" regardless of your proceeds and post-production costs.

• *WHAT ARE THE TERMS OF ART BEING USED?*

Avoid using "gross proceeds" and having the royalty gas delivered "in the pipeline" if at all possible.

• *IS THERE AN ADDENDUM OR DELETION TO THE LEASE THAT ATTEMPTS TO CHANGE THE ROYALTY PROVISION?*
Does it specifically exclude all or any specific post-production costs? Does it attempt to move the royalty valuation point from the well to the sales delivery point? Can it be construed as "surplusage" instead of an amendment?

• *IF THE LEASE IS NOT ENTIRELY CLEAR, CAN A DIVISION ORDER SPECIFICALLY ADDRESS WHAT CAN BE DEDUCTED FROM THE SALES PRICE?*

Remember that the division order is probably revocable as to future costs and subject to a "fairness" attack as to past costs, especially if the lessee and division order addressee are one and the same.

• *ARE THE COSTS TO BE DEDUCTED ACTUAL AND REASONABLE?*

Evaluating the methodology, especially any rate of return, cost of money, depreciation and overhead costs, should all be measured by this standard. Being able to support the costs with third party bids equal to or greater than the proposed charge is perhaps the best protection.

• *IS THE GAS BEING SOLD TO OR PROCESSED BY AN AFFILIATED COMPANY?*

Remember the "higher scrutiny" standard and have the sales price or post-production charges supported by independent prices or charges of comparable gas. Make sure the charges to be deducted are not in excess of actual costs, even if the comparable charges or net prices are higher.

•***Remember Exxon v. Alabama and don't be greedy.***

MUDDY WATERS, BLUE SKIES: CIVIL LIABILITY UNDER THE MISSISSIPPI SECURITIES ACT

Keith A. Rowley[*]

[I]nadequate budgets and uneven enforcement of the blue sky laws make civil liability the only effective sanction in many states—perhaps most states. Outside of California and a handful of other states, criminal prosecutions are undertaken sporadically and only with extreme reluctance. By the same token most administrators shy away generally from formal disciplinary proceedings . . . . But the threat of rescission or damages is always present.[1]

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[1] IX LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 4131-33 (3d ed. 1992); *see also* E. Clifton Hodge, Jr., *Civil Liability Under the Mississippi Securities Act*, 43 MISS. L.J. 597, 597-98 (1972) ("[I]n a state such as Mississippi where funds available for the administrative regulation of securities are definitely limited, civil liability may be the only effective means of enforcement.").

That said, there is a relative dearth of reported Mississippi case law discussing civil securities liability—a problem that has been noted before. *See* Hodge, *supra* at 598 (noting "there is very little authority" to draw upon for purposes of exploring civil liability under Mississippi Securities Act); L. Keith Parsons, *A Review of Interpretive Opinions and Enforcement Proceedings Under the Mississippi Securities Act*, 12 MISS. C. L. REV. 179, 179 (1991) ("Judicial interpretation of the [Mississippi Securities] Act . . . is almost nonexistent."); Bryn Vaaler, *Financing a Small Business in Mississippi: A Practitioner's Guide to Federal and States Securities Exemptions—Part II*, 63 MISS. L.J. 267, 325 (1994) ("Judicial interpretation of the Mississippi Securities Act and the Mississippi Blue Sky Rules has been extremely sparse."); Richard Baxter Wilson, Jr., Comment, *Selling the Blue Sky in Mississippi—A Comparison of the Mississippi Securities Act with the Uniform Securities Act*, 35 MISS. L.J. 421, 421 (1964) ("[N]o case has yet reached the Mississippi Supreme Court . . . ."). Fortunately, the Mississippi Secretary of State's Business Services (neé Securities) Division has issued a number of private interpretive opinions—similar to "no-action" letters issued by

I. INTRODUCTION

The decade of the 1990s produced a series of actions by the United States Supreme Court and by Congress that, collectively, reduced the number of avenues by which plaintiffs relying on federal law may pursue alleged wrongdoers for securities fraud; imposed significant additional requirements on plaintiffs suing under federal securities law; preempted state registration requirements for several classes of securities; and curbed the availability of state courts as an alternative forum in which plaintiffs may pursue securities fraud claims.[2] And yet, in spite of these changes, "Congress, the courts, and the SEC have

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the U.S. Securities Exchange Commission—and Cease and Desist Orders that provide additional guidance on the scope and contours of the Mississippi Securities Act. Several hundred of these are available on line through LEXIS's Mississippi Secretary of State, Securities Division database (STATES; MSSEC) and are cited throughout this article, most often during the discussion of registration issues. *See infra* notes 14, 19, 23-31, 35-43, 46, 49, 52, 54-55, 58-63, 65-72, 78-79, 83-89, 92-94, 113-14, and 129-35. For a thorough review of interpretive opinions and enforcement orders issued from 1985 through 1991, see Parsons, *supra*.

[2] Namely, the Supreme Court's decisions in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 176-78 (1994) (eliminating implied private cause of action for aiding and abetting securities fraud), and *Gustafson v. Alloyd Co.*, 513 U.S. 561, 576-77 (1995) (holding section 12(a)(2) of 1933 Securities Act applies only to public offerings), Congress's passage of the Private Securities Litigation Reform Act (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (1995) (reforming number of relevant substantive and procedural provisions of both 1933 Securities Act and 1934 Securities Exchange Act), the National Securities Market Improvement Act (NSMIA), Pub L. No. 104-290, 110 Stat. 3416 (1996), *codified at* 15 U.S.C. § 77r (Supp. V 1999) (amending 1933 Securities Act to eliminate its provision allowing concurrent state regulation of several categories of securities offerings), and the Securities Litigation Uniform Standards Act (SLUSA), Pub. L. No. 105-353, 112 Stat. 3227 (1998), *codified at* 15 U.S.C. § 77p & § 78bb(f) (preempting most state court securities class actions and empowering defendants to remove to federal court securities class actions filed in state court).

For discussions of the foregoing cases and legislation and their impact on state securities law, see Keith A. Rowley, *The Sky is Still Blue in Texas: State Law Alternatives to Federal Securities Remedies*, 50 BAYLOR L. REV. 99, 103-06 (1998) [hereinafter Rowley, *The Sky is Still Blue*], and the sources cited therein; Keith A. Rowley, *They Toil Not, Neither Do They Spin: Civil Liability Under the Oregon Securities Law*, 37 WILLAMETTE L. REV. 335, 337-41 (2001) [hereinafter Rowley, *They Toil Not*].

made explicit that federal regulation was not designed to displace state blue sky laws."[3]

As a general rule, Mississippi law holds those who sell securities in violation of statutory registration requirements,[4] or by means of some misrepresentation or omission of material fact,[5] liable to anyone who buys securities from or through them. Likewise, those who buy securities by means of some misrepresentation or omission of material fact may be liable to anyone who sells securities to or through them.[6] In addition to, or in lieu of,[7] those who committed the material misrepresentation or omission, liability for the consequences of a misrepresentation or omission may extend vicariously to others who are closely related to the primary wrongdoer or were involved in the transaction at issue.[8]

To the extent not foreclosed by recent changes in federal law,[9] many acts and omissions that will give rise to liability under Mississippi law will also give rise to liability under federal securities law.[10] Some federal securities claims may be

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[3] A.S. Goldmen & Co. v. N.J. Bureau of Sec., 163 F.3d 780, 781 (3d Cir.), *cert. denied*, 528 U.S. 868 (1999).

[4] *See* MISS. CODE ANN. §§ 75-71-401, -717(a)(1) (2000); *infra* Part II.B.

[5] *See* MISS. CODE ANN. § 75-71-717(a)(2); *see also* Seaboard Planning Corp. v. Powell, 364 So. 2d 1091, 1093-94 (Miss. 1978) (holding seller of securities liable for violating anti-fraud provisions of precursor to current Mississippi Securities Act); First Mobile Home Corp. v. Little, 298 So. 2d 676, 679 (Miss. 1974) (holding seller of securities liable for common law fraud). See *infra* Part II.C for a discussion of primary liability for statutory securities fraud.

[6] The general anti-fraud provision of the Mississippi Securities Act (MSA) prohibits fraud in both the sale and purchase of securities. *See* MISS. CODE ANN. § 75-71-501. However, Mississippi courts refuse to recognize an implied cause of action under section 501. *See* Allyn v. Wortman, 725 So. 2d 94, 102 (Miss. 1998). The primary civil remedial provision holds liable only those who offer to sell or do sell securities in contravention of the MSA, not those who offer to buy or do buy. *See* MISS. CODE ANN. § 75-71-717(a)(2). Fortunately for aggrieved sellers, the lack of sellers' remedies in the MSA does not preempt them from bringing common law claims. *See, e.g.*, Gray v. Baker, 485 So. 2d 306, 308 (Miss. 1986) (permitting seller to rescind contract with buyer based on buyer's fraud).

[7] *See infra* note 167 and accompanying text.

[8] *See* MISS. CODE ANN. § 75-71-719; *infra* Part II.D.

[9] *See supra* note 2 and accompanying text.

[10] Federal securities law imposes liability for failing to comply with applicable registration requirements. *See* 15 U.S.C. § 77*l*(a)(1) (Supp. V 1999). Federal securities law also contains three primary civil anti-fraud provisions: section 11 of the

brought in Mississippi state court,[11] while others may not.[12] In any event, while this Article focuses on Mississippi law, readers who have not already done so should familiarize themselves with the relevant federal statutory provisions and precedent—both because federal and state liability overlap to a significant degree,[13] and because numerous provisions of Mississippi securities law are derived from or closely resemble federal law, leading Mississippi courts frequently to resort to cases construing analogous federal provisions in order to construe and apply Mississippi law.[14]

1933 Securities Act, *id.* § 77k (1994); section 12(a)(2) of the 1933 Securities Act, 15 U.S.C. § 77*l*(a)(2) (Supp. V 1999); and section 10(b) of the 1934 Securities Exchange Act, 15 U.S.C. § 78j(b) (1994). Section 11 addresses misrepresentations and omissions in registration statements filed with the Securities Exchange Commission. Section 12(a)(2) addresses misrepresentations and omissions "in connection with" a public offering of securities. Section 10(b), actionable through Rule 10b-5, 17 C.F.R. § 240.10b-5 (2000), is the general anti-fraud provision. For an excellent introduction to federal securities law, see LARRY D. SODERQUIST, UNDERSTANDING THE SECURITIES LAWS (3d ed. 1997 & Supp. 2000). For the definitive treatment, see LOSS & SELIGMAN, *supra* note 1.

[11] Claims under section 11 or 12 may be brought in either federal or state court, and cannot be removed other than for diversity of citizenship. *See* 15 U.S.C. § 77v(a) (Supp. V 1999); Wilko v. Swan, 346 U.S. 427, 430 (1953), *overruled on other grounds by* Rodriguez de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 484 (1989); Luce v. Edelstein, 1985 WL 2257, at *2 (S.D.N.Y. Aug. 8, 1985); Moran v. Paine, Webber, Jackson & Curtis, 279 F. Supp. 573, 577 (W.D. Pa. 1966), *aff'd*, 389 F.2d 242 (3d Cir. 1968).

[12] Claims under section 10(b)/Rule 10b-5 must be brought in federal court. *See* 15 U.S.C. § 78aa (1994); Lang v. French, 154 F.3d 217, 221 (5th Cir. 1998). The exclusive jurisdiction of the federal courts over section 10(b)/Rule 10b-5 claims is subject to knowing waiver in favor of arbitration, *see* Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 227-28 (1987), but not in favor of state court.

[13] *See, e.g.*, Johnson v. Yerger, 612 F.2d 953, 955 (5th Cir. 1980) (plaintiffs brought claims under 1933 Securities Act, 1934 Securities Exchange Act, Rule 10b-5 and MSA, all arising from single transaction); Shivangi v. Dean Witter Reynolds, Inc., 107 F.R.D. 313, 315 (S.D. Miss. 1985) (plaintiffs claimed under Rule 10b-5, section 501 of MSA and Mississippi common law).

[14] *See, e.g.*, Allyn v. Wortman, 725 So. 2d 94, 102 (Miss. 1998) (basing its refusal to recognize implied private cause of action under section 501 of MSA, MISS. CODE ANN. § 75-71-501, on fact that there is no implied private cause of action under section 17(a) of 1933 Securities Act, 15 U.S.C. § 77q(a), with which section 501 is "virtually identical"); *In re* Stewart, No. 97-05-59, 1998 Miss. Sec. LEXIS 3, at *5 (Aug. 27, 1998) (adopting test set out in *Reves v. Ernst & Young*, 494 U.S. 56, 64-65 (1990), for whether promissory notes are securities); *see also, e.g.*, Tatum v. Smith, 887 F. Supp. 918, 924 n.6 (N.D. Miss. 1995) (summarily dismissing plaintiffs' "control person" claims under MSA because MSA's control

II. Statutory Liability Under the Mississippi Securities Act[15]

The Mississippi Securities Act (MSA) imposes liability on any person[16] who sells or offers to sell a security in violation of the MSA's registration requirements.[17] Irrespective of whether the security at issue was required to be and was properly registered, the MSA also imposes liability on any person who sells or offers to sell a security by means of an untrue statement of material fact or an omission of material fact necessary to make those statements that were made true.[18]

A. Key Concepts

The registration and antifraud provisions of the MSA apply only to devices or transactions the MSA deems to be "securities," and are triggered by their unauthorized or unlawful offer or sale.

1. The Meaning of "Security"

The MSA defines "security" to mean

> any note; stock; treasury stock; bond; debenture; evidence of indebtedness; certificate of interest or participation in any profit-sharing agreement; collateral-trust certificate; preorganization certificate or subscription; transferable share; invest-

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person liability provision "mirrors" that of 1933 Securities Act, claims which court had already disposed of); Fortenberry v. Foxworth Corp., 825 F. Supp. 1265, 1279 (S.D. Miss. 1993) ("The nearly identical language of § 501 and Rule 10b-5 leads this court to the inexorable conclusion that they have nearly identical purposes.").

[15] The discussion here and elsewhere in this article focuses solely on civil liability for violations of the applicable provisions of the MSA. However, an unregistered person selling securities not otherwise exempt under the MSA, as well as any person selling unregistered securities not otherwise exempt under the MSA, may also face criminal liability. *See* Miss. Code Ann. § 75-71-735; Campbell v. State, 743 So. 2d 1050, 1053-54 (Miss. Ct. App. 1999).

[16] For purposes of the MSA, "person" includes corporations, partnerships, joint stock companies, associations, syndicates and other business entities. *See* Miss. Code Ann. § 75-71-105(k).

[17] *See supra* note 4 and accompanying text.

[18] *See supra* note 5 and accompanying text.

ment contract; voting-trust certificate; certificate of deposit for a security; certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease; interest in a limited partnership; viatical settlement investment contract or a fractionalized or pooled interest therein; or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing, excluding] any insurance or endowment policy or annuity contract under which an insurance company promises to pay a fixed or variable sum of money, or both, either in a lump sum or periodically for life or some other specified period.[19]

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[19] MISS. CODE ANN. § 75-71-105(n); *see, e.g.*, *In re* Millennicom, Inc., No. 00-041, 2000 Miss. Sec. LEXIS 4, at *4 (Oct. 18, 2000) (promissory notes); *In re* S. States Meat Goat Coop., No. 98-013, 1998 Miss. Sec. LEXIS 31, at *1 (Jan. 22, 1998) (preferred and common stock); *In re* Brantley Capital Corp., No. 97-06-15, 1997 Miss. Sec. LEXIS 15, at *1 (Sep. 16, 1997) (investment company shares); *In re* Money Makers Int'l, No. 93-10-22, 1994 Miss. Sec. LEXIS 7, at *1 (Jan. 12, 1994) (common stock); *In re* Interlochen Group, Inc., No. 93-09-01, 1993 Miss. Sec. LEXIS 16, at *1 (Nov. 9, 1993) (stock); *In re* Gen. Research Indus. Inc., No. CD-90-1-3, 1990 Miss. Sec. LEXIS 2, at *1 (Jan. 24, 1990) (common stock); *In re* Bond Servs. Int'l Corp., No. 89-08-11, 1989 Miss. Sec. LEXIS 1, at *2 (Oct. 18, 1989) (bonds); *In re* Hi-Tech Plastic Mfg. Co., No. CD-90-1-2, 1990 Miss. Sec. LEXIS 3, at *1 (Jan. 18, 1990) (stock); *In re* First Enterprizes, Inc., No. 88-1-08, 1988 Miss. Sec. LEXIS 3, at *1-3 (May 19, 1988) (oil, gas or mining title, lease, or payments participation).

By comparison, section 2 of the 1933 Securities Act defines "security" to mean

> any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

15 U.S.C. § 77b(a)(1) (Supp. V 1999).

The definition of "security" in section 3 of the 1934 Securities Exchange Act is largely the same as that contained in section 2 of the 1933 Securities Act, al-

a. Investment Contract

By rule, the Secretary of State has defined "investment contract" to mean "any interest or participation in a contract, transaction, scheme, common enterprise, or profit-seeking venture whereby a person invests therein and looks primarily to the promoter or a third party for the financial success of such venture."[20] This is consistent with the "modified *Howey* test"[21] employed by federal courts and most other states.[22]

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though section 3 excludes "evidence of indebtedness" and "guarantees of" the various devices specified in the definition, describes oil, gas and mineral interests somewhat differently and explicitly excludes "currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited." *Id.* § 78c(a)(10). Despite these differences, courts generally treat the definitions of "security" in the two acts as functionally interchangeable. *See, e.g.*, Landreth Timber Co. v. Landreth, 471 U.S. 681, 686 n.1 (1985); Great Rivers Coop. v. Farmland Indus., Inc., 198 F.3d 685, 698 (8th Cir. 1999).

For an enlightening examination of the evolving statutory definition and judicial application of the term "security," see Theresa A. Gabaldon, *A Sense of Security: An Empirical Study*, 25 J. CORP. L. 307, 312-47 (2000). For a somewhat dated discussion of the same issues under state law, see Douglas M. Branson & Karl Shumpei Okamoto, *The Supreme Court's Literalism and the Definition of "Security" in the State Courts*, 50 WASH. & LEE L. REV. 1043, 1060-68 (1993). *See generally* II LOSS & SELIGMAN, *supra* note 1, at 923-1138.19; Gary S. Rosin, *Historical Perspectives on the Definition of a Security*, 28 S. TEX. L. REV. 575, 597-610 (1987).

[20] Rule 103(H), Miss. Blue Sky Regs., *reprinted in* 2A BLUE SKY L. REP. (CCH) ¶ 34,403, at 29,402.

[21] *Policy Statement on Viatical Settlements*, Feb. 25, 2000, reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,627, at 29,553.

> The Secretary of State considers the United States Supreme Court's analysis in *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) to be persuasive in defining the term "investment contract". The *Howey* test holds that an investment contract has four principal elements or criteria: (i) the investment of money; (ii) in a common enterprise; (iii) with an expectation of profits; (iv) to be earned through the efforts of others. The fourth prong of the *Howey* test was clarified in *SEC v. Glenn W. Turner Enterprises*, which held that the "efforts" referred to "are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." *SEC v. Glenn W. Turner Enterprises*, 474 F.2d 476, 482 (9th Cir.) *cert. denied*, 414 U.S. 821 (1973). The Secretary concurs in this reasoning.

Id.

[22] *See, e.g.*, United Hous. Found., Inc. v. Forman, 421 U.S. 837, 852 (1975);

In enforcement proceedings, the Business Services Division

SEC v. Banner Fund Int'l, 211 F.3d 602, 614 (D.C. Cir. 2000); Great Rivers Co-op. v. Farmland Indus., 198 F.3d 685, 700 (8th Cir. 1999); SEC v. Unique Fin. Concepts, 196 F.3d 1195, 1199 (11th Cir. 1999); Matassarin v. Lynch, 174 F.3d 549, 560 (5th Cir. 1999), *cert. denied*, 528 U.S. 1116 (2000); Allen v. Lloyd's of London, 94 F.3d 923, 930 (4th Cir. 1996); Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994); SEC v. Eurobond Exch., Ltd., 13 F.3d 1334, 1338 (9th Cir. 1994); Stone v. Kirk, 8 F.3d 1079, 1085 (6th Cir. 1993); RTC v. Stone, 998 F.2d 1534, 1540 (10th Cir. 1993); Rodriguez v. Banco Cent. Corp., 990 F.2d 7, 10 (1st Cir. 1993); Schlifke v. Seafirst Corp., 866 F.2d 935, 941 (7th Cir. 1989); Hamblett v. Bd. of Sav. & Loan Assocs., 472 F. Supp. 158, 165 (N.D. Miss. 1979); Nutek Info. Sys., Inc. v. Arizona Corp. Comm'n, 977 P.2d 826, 830 (Ariz. Ct. App. 1998), *cert. denied*, 528 U.S. 932 (1999); SEC v. Infinity Group Co., 212 F.3d 180, 187 (3d Cir. 2000), *cert. denied*, 121 S. Ct. 1228 (2001); Feigin v. Digital Interactive Assocs., 987 P.2d 876, 881 (Colo. Ct. App. 1999); Brown v. Rairigh, 363 So. 2d 590, 592-93 (Fla. Dist. Ct. App. 1978); Huggins v. Chapin, 489 S.E.2d 109, 111 (Ga. Ct. App. 1997); State v. Res. Serv. Co., 950 P.2d 249, 253-54 (Idaho 1997); Ronnett v. Am. Breeding Herds, Inc., 464 N.E.2d 1201, 1203 (Ill. App. Ct. 1984); State v. Kraklio, 560 N.W.2d 16, 18 (Iowa 1997); State *ex rel.* Owens v. Colby, 646 P.2d 1071, 1077 (Kan. 1982); Dep't of Commerce v. DeBeers Diamond Inv., Ltd., 280 N.W.2d 547, 550 (Mich. Ct. App. 1979); State v. Kramer, 804 S.W.2d 845, 849 (Mo. Ct. App. 1991); State v. Jones, 453 N.W.2d 447, 451 (Neb. 1990); State v. Danek, 878 P.2d 326, 328-29 (N.M. 1994); People v. First Meridian Planning Corp., 614 N.Y.S.2d 811, 816-17 (N.Y. App. Div. 1994), *aff'd*, 658 N.E.2d 1017 (N.Y. 1995); Tschetter v. Berven, 621 N.W.2d 372, 376 (S.D. 2001); Busse v. Pac. Cattle Feeding Fund No. 1, Ltd., 896 S.W.2d 807, 814 (Tex. App. 1995); Sauve v. K.C., Inc., 591 P.2d 1207, 1209 (Wash. 1979).

A handful of states have recognized an alternative to the modified *Howey* test: the "risk capital" test, under which an instrument or transaction is an "investment contract" if the buyer provides a substantial portion of the initial capital a seller uses to initiate its operations—and, hence, is at the greatest risk of being lost because the venture turns out not to be viable—without the right to actively participate in the management of the venture. *See, e.g.*, Smith v. State, 587 S.W.2d 50, 52 (Ark. Ct. App. 1979); Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908 (Cal. 1961); State v. Haw. Mkt. Ctr., Inc., 485 P.2d 105, 109 (Haw. 1971); State v. George, 362 N.E.2d 1223, 1227 (Ohio Ct. App. 1975); State *ex rel.* Healy v. Consumer Bus. Sys., Inc., 482 P.2d 549, 554-55 (Or. Ct. App. 1971); State v. Brewer, 932 S.W.2d 1, 13-14 (Tenn. Ct. Crim. App. 1996); *see also, e.g.*, Artistic Door Corp. v. Rheney, 384 So. 2d 179, 181-82 (Fla. Dist. Ct. App.) (finding transaction at issue to be "security" under both modified *Howey* test and "risk capital" test). The "risk capital" test

> requires a consideration of the following factors: (1) whether funds are being raised for a business venture or enterprise; (2) whether the transaction is offered indiscriminately to the public at large; (3) whether the investors are substantially powerless to effect the success of the enterprise; and (4) whether the investors' money is substantially at risk because it is inadequately secured.

Moreland v. Dep't of Corps., 239 Cal. Rptr. 558, 566 (Cal. Dist. Ct. App. 1987).

has found a variety of transactions or devices to be investment contracts, including, e.g., purchases of emus with the option of having the seller care for and market the emus on behalf of the purchaser;[23] passive investments in an offshore "trust fund," the proceeds of which were to be used for international currency arbitrage by a third party;[24] offers of interest-free loans with an option to allow the offeror to invest and manage the loan proceeds on behalf of the offerees;[25] and passive investments in (non-existent) thoroughbred racing horses.[26]

The Business Services Division has found memberships in a "venture capital trust" organized for the purpose of soliciting applications (and, more importantly, application fees) for funds from the trust,[27] investments in a mail-order and advertising business from which the passive investors expected to receive "tax-free" cash payments based on the amount invested,[28] membership, joint venture, or partnership interests through which individuals invest funds to be pooled with those of other investors for the purpose of developing and expanding a wireless cable television system,[29] and investments to be pooled with those of other investors to be used to seek a license from the Federal Communication Commission to operate an Interactive Television System to be "investment contracts and/or

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[23] *In re* S & W Emu Ranch, No. 94-10-05, 1994 Miss. Sec. LEXIS 13, at *1 (Nov. 30, 1994).

[24] *In re* Swiss Trade & Commerce Trust, No. 94-04-09, 1994 Miss. Sec. LEXIS 12, at *1 (July 8, 1994); *In re* Prof'l Mktg. Servs., No. 94-04-10, 1994 Miss. Sec. LEXIS 11, at *1 (June 3, 1994).

[25] *In re* Dooley Billiu, No. 89-10-07, 1989 Miss. Sec. LEXIS 2, at *1-2 (Nov. 27, 1989).

[26] *In re* BMT Racing Stables, No. CD 86-8-1, 1986 Miss. Sec. LEXIS 1, at *1-2 (Sep. 10, 1986).

[27] *In re* Apex Co., No. 96-12-001, 1996 Miss. Sec. LEXIS 21, at *1-2 (Dec. 31, 1996).

[28] *In re* G.C.M.C., No. 96-08-046, 1996 Miss. Sec. LEXIS 20, at *1-2 (Nov. 4, 1996).

[29] *In re* Diversified Wireless Holdings, No. 95-01-02, 1995 Miss. Sec. LEXIS 17, at *1 (Mar. 23, 1995); *In re* Golden Triangle Wireless Television P'ship, No. 95-03-02, 1995 Miss. Sec. LEXIS 20, at *1-2 (Mar. 22, 1995); *In re* National Wireless Group, No. 95-03-04, 1995 Miss. Sec. LEXIS 22, at *1-2 (Mar. 22, 1995); *In re* Cont'l Wireless Cable Television, Inc., No. 95-01-01, 1995 Miss. Sec. LEXIS 21, at *1-2 (Jan. 2, 1995).

participations in a profit-sharing agreement."[30]

The Business Services Division has also encountered several transactions or devices that it has determined to be an investment contract and/or "certificate of interest or participation in an oil, gas or mining title or lease or in payments out of production under such a title or lease."[31]

b. Notes

As do the comparable provisions of both the 1933 Securities Act and the 1934 Securities Exchange Act,[32] the MSA explicitly includes "notes" in its definition of "security."[33] As did the United States Supreme Court in *Reves v. Ernst & Young*,[34] the Business Services Division has concluded that "[e]ven though the plain language of the statute provides that any note is a security, that is not the end of the inquiry."[35] Again following the lead of the *Reves* Court, the Division has adopted a four-part test to determine whether a particular note is a "security" for purposes of the MSA:

> The Court in *Reves* adopted a four-part test for determining when a note so closely resembles an instrument in the above list of categories that it is not a security. The elements

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[30] *In re* Pathway Planning, Inc., No. 93-11-14, 1993 Miss. Sec. LEXIS 18, at *2 (Nov. 17, 1993).

The Division allowed that this particular interest might also qualify as an "interest in a limited partnership." *See id.* The MSA, unlike parallel federal law, specifically includes limited partnership interests in its statutory definition of "security." *See supra* note 19 and accompanying text.

[31] *See, e.g.*, *In re* Myers & Assocs., No. 94-04-08, 1994 Miss. Sec. LEXIS 14, at *1-2 (Apr. 28, 1994); *In re* Basa Res., Inc., No. 91-07-21, 1991 Miss. Sec. LEXIS 15, at *1-3 (July 25, 1991); *In re* Rich-Ken, Inc., No. CD-90-1-1, 1990 Miss. Sec. LEXIS 1, at *1-3 (Apr. 2, 1990).

Neither the 1933 Securities Act nor the 1934 Securities Exchange Act explicitly include oil, gas or mineral title, lease or payment participations in their definitions of "security." *See supra* note 19.

[32] *See supra* note 19.

[33] MISS. CODE ANN. § 75-71-105(n) (2000).

[34] 494 U.S. 56 (1990).

[35] *In re* Stewart, No. 97-05-59, 1998 Miss. Sec. LEXIS 3, at *5 (Aug. 27, 1998); *cf. Reves*, 494 U.S. at 62-63 (advising "the phrase 'any note,'" in section 3(a)(10) of the Exchange Act, "should not be interpreted to mean literally 'any note,' but must be understood against the backdrop of what Congress was attempting to accomplish in enacting the Securities Acts").

to be considered in the four-part test are:

(1) The motivations that would prompt a reasonable seller and buyer to enter into it. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the interest is likely to be a "security;"

(2) The "plan of distribution" of the instrument to determine whether it is an instrument in which there is "common trading for speculation or investment" (citation omitted);

(3) The reasonable expectations of the investing public; [and]

(4) Whether some factor such as the existence of another regulatory scheme significantly reduces the risk of the instrument, thereby rendering application of the Securities Acts unnecessary.[36]

Applying the *Reves* test to the promissory notes at issue, the Division found they were "securities" where: (1) "the buyers . . . purchased the notes to earn a profit in the form of interest and the sellers sold the notes to raise capital for the[ir] business;"[37] (2) the notes "were distributed to the general public through a network of at least fifteen agents" resulting in the purchase of "over $2 million . . . worth of these promissory notes [by] at least 31 investors" in Mississippi;[38] (3) "[t]he disclosure document used to place the . . . notes refer[red] to them as 'prime investment grade commercial notes'" and "highlight[ed] the investment quality of the instruments;"[39] and (4) notwithstanding the disclosure document's representations to the contrary,[40]

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[36] *Stewart*, 1998 Miss. Sec. LEXIS 3, at *6-7 (citations and parentheticals omitted) (quoting *Reves*, 494 U.S. at 66).

[37] *Id.* at *10.

[38] *Id.* at *10-11.

[39] *Id.* at *11.

[40] *See id.* at *11-12 ("The . . . disclosure document states that 'the Notes will be partially secured on a revolving basis by U.S. Government Securities and other investments of comparable safety, cash reserves, and a perfected security interest in the Company's loan portfolio.' However, Respondents offered no proof that such risk reducing factors actually were in place." (record citation omitted)).

> were it not for the applicability of the securities laws, these notes would not be subject to any substantial regulatory scheme. They were not insured by the Federal Deposit Insurance Corporation, and nothing in the record suggests that they were subject to regulation under the Employee Retirement Income Security Act of 1974 or any other substantial regulatory scheme. Therefore, it is impossible to find that these notes bear a significant resemblance to any of the consumer or commercial notes making up the list of non-security notes in *Reves*.[41]

c. Other Types of "Securities"

The MSA and the Mississippi Blue Sky Rules offer no further guidance, and there are no reported decisions of the Mississippi Supreme Court or the Mississippi Court of Appeals addressing whether a particular transaction or device constitutes a security for purposes of section 105 or any of its predecessors.

Enforcement proceedings brought by the Secretary of State necessarily consider whether the transaction or device at issue is a security[42]—although the discussion in the published order is typically brief and often conclusory. Likewise, the Business Services Division occasionally addresses in an interpretive ruling the issue of whether a transaction or device is a security[43]—although, again, the discussion is typically brief. To the extent that a question arises that is not clearly resolved by resort to the language of section 105, or Rule 103(H), or by re-

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[41] *Id.* at *12-13 (record citation omitted).

[42] *See, e.g., In re* J. F. (Jim) Straw, No. 92-04-08, 1992 Miss. Sec. LEXIS 17, at *2 (Apr. 17, 1992) (finding agreement or contract under which person agrees to periodically pay small amounts of money in order to receive larger, interest-free loan at some future date to be determined by promoter was note and/or evidence of indebtedness and/or investment contract); *see also supra* notes 23-31 and accompanying text.

[43] *See, e.g.*, Vistana Fountains Condominiums, 1990 Miss. Sec. LEXIS 38, at *1 (Jan. 18, 1990) (opining "unit weeks" in condominium time share arrangement were not securities); Hardware Wholesalers, Inc., 1985 Miss. Sec. LEXIS 1, at *1 (Apr. 9, 1985) (opining, without explaining, that certain common stock was not "security" under MSA). *See generally* Parsons, *supra* note 1, at 182-83.

view of what guidance is available from the Business Services Division, Mississippi courts will have to look to cases construing analogous provisions in the federal securities acts[44] and to the securities acts of sister states.[45]

2. *"Sale" of or "Offer to Sell" Securities*

Subject to certain exceptions,[46] the MSA defines "sale" and "offer to sell" to include: (1) every contract of sale of, contract to sell, or disposition of, a security or interest in a security for value; (2) every attempt to dispose of, or solicitation of an offer to buy, a security or interest in a security for value; (3) any gift or delivery of securities with, or as a bonus on account of, a purchase of securities; (4) any gift of assessable

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[44] *See supra* note 14 and accompanying text.

[45] *See generally* 12 JOSEPH C. LONG, BLUE SKY LAW ch. 2 (2000), and cases cited therein.

[46] The MSA explicitly excludes the following from its definition of "sale":

> (A) any bona fide pledge or loan; (B) any stock dividend, whether the corporation distributing the dividend is the issuer of the stock or not, if nothing of value is given by stockholders for the dividend other than the surrender of a right to a cash or property dividend when each stockholder may elect to take the dividend in cash or property or in stock; (C) any act incident to a class vote by stockholders, pursuant to the certificate of incorporation or the applicable corporation statute, on a merger, consolidation, reclassification of securities, or sale of corporate assets in consideration of the issuance of securities of another corporation; or (D) any act incident to a judicially approved reorganization in which a security is issued in exchange for one or more outstanding securities, claims or property interests, or partly in such exchange and partly for cash.

MISS. CODE ANN. § 75-71-105(*l*)(6) (2000).

These exceptions appear to prompt the most inquiries for interpretive guidance from the Business Services Division. Keith Parsons reported a decade ago that, "[f]rom 1985 through 1991 there were over 50 interpretations of this section of the Act." *See* Parsons, *supra* note 1, at 183 n.30. From 1992 through December 31, 2000, there appear to have been at least another thirty-one inquiries answered. Interestingly, all thirty-one related to section 105(j)(6)(C)—the exclusion relating to mergers, consolidations and sales of corporate assets. *See, e.g.*, Affiliated Research Ctrs., Inc., 1996 Miss. Sec. LEXIS 13, at *1-3 (Sept. 16, 1996); Liberte Investors, 1996 Miss. Sec. LEXIS 15, at *1 (June 28, 1996); Mentor Capital Growth Portfolio (Exchange Offer), 1995 Miss. Sec. LEXIS 11, at *1 (June 14, 1995); State Mut. Life Assurance Co., 1995 Miss. Sec. LEXIS 8, at *1 (Mar. 7, 1995); Midland Mut. Life Ins. Co., 1994 Miss. Sec. LEXIS 4, at *1 (May 12, 1994); SAFECO Growth Fund, Inc., 1993 Miss. Sec. LEXIS 14, at *1 (July 23, 1993).

stock by or for any issuer or promoter; and (5) any sale or offer of an option, warrant, or other right to purchase or subscribe to a security.[47]

3. *"In Mississippi"*

A person who sells or offers to sell securities will only be liable under the MSA if an offer to sell is made in Mississippi, or an offer to buy is made and accepted in Mississippi.[48] An offer to sell is "made in" Mississippi, whether or not either party to the transaction is then present in Mississippi, when the offer: (1) "originates from" Mississippi or (2) is "directed by the offeror to" and received in Mississippi.[49] An offer to buy is "accepted in" Mississippi when the buyer, not having previously accepted the offer elsewhere, directs his acceptance to the offeror in Mississippi "reasonably believing the offeror to be in [Mississippi], and it is received at the place to which it is directed."[50]

B. Registration Liability Under the MSA

Section 401 makes it unlawful to sell or offer to sell an unregistered security in the state of Mississippi unless (1) the security is exempt under section 201; (2) the security is a "federal covered security;" (3) the transaction is exempt under section 203; or (4) the security or transaction has been exempted by rule or order of the Secretary of State in accordance with section 109(a).[51]

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[47] MISS. CODE ANN. § 75-71-105(*l*)(1)-(5).

[48] *Id.* § 75-71-119(a).

[49] *See id.* § 75-71-119(c); *In re* Stewart, No. 97-05-59, 1998 Miss. Sec. LEXIS 3, at *2, 13 (Aug. 27, 1998) (Florida-based issuer sold notes to thirty-one residents of Mississippi); *In re* Myers & Assocs., Inc., No. 94-04-08, 1994 Miss. Sec. LEXIS 14, at *4 (Apr. 28, 1994) (offers originated from respondent's Gulfport, Mississippi offices); *In re* Basa Resources, Inc., No. 91-07-21, 1991 Miss. Sec LEXIS 15, at *1 (July 25, 1991) (offers were mailed to Mississippi investors from Dallas, Texas).

[50] MISS. CODE ANN. § 75-71-119(d).

[51] *See id.* § 75-71-401.

Securities may be registered, for purposes of section 401, either under the auspices of the MSA, *see id.* §§ 75-71-403, -405, or -408, or the Mississippi Affordable College Savings Plan, *see id.* § 37-15-515.

1. Exemptions from Registration

The MSA exempts offers and sales of securities from the reach of section 401 based on the nature of the securities themselves, the nature of the transaction in which the securities are offered or sold, or both; the seller or offeror claiming an exemption bears the burden of pleading and proving the exemption's applicability.[52]

a. Exempt Securities

Section 201 exempts certain securities from registration, notwithstanding whether the transaction involved is otherwise exempt.[53] Section 201 exempts most securities issued or guaranteed by: (1) the federal government, including any agency or instrumentality of the federal government;[54] (2) a state, a po-

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A "federal covered security" is "a covered security under section 18(b) of the Securities Act of 1933 or rules or regulations promulgated thereunder." *Id.* § 75-71-105(d).

In addition to requiring registration of securities sold or offered for sale in the state of Mississippi, the MSA also requires, subject to certain exemptions, the registration of all broker-dealers and agents who transact or offer to transact securities business in the state of Mississippi. *See id.* § 75-71-301; *id.* § 75-71-105(a) (defining "agent"); *id.* § 75-71-105(b) (defining "broker-dealer"); *id.* § 75-71-105(g) (defining "investment adviser"); *id.* § 75-71-105(h) (defining "investment adviser representative"). The regulation of broker-dealers, agents, investment advisers and investment adviser representatives, except in their capacities as buyers and sellers of securities and as culpable collateral participants in the purchase or sale of securities, is beyond the scope of this article.

[52] *See id.* § 75-71-207; Blinder, Robinson & Co., 1990 Miss. Sec. LEXIS 14, at *1 (Jan. 17, 1990); Staple Cotton Disc. Corp., 1987 Miss. Sec. LEXIS 41, at *1 (Nov. 9, 1987).

[53] MISS. CODE ANN. § 75-71-201. The section 201 exemptions generally track those contained in section 402(a) of the 1956 Uniform Securities Act, 7C U.L.A. 218-19 (2000), after which the current version of the MSA is modeled. *See* Vaaler, *supra* note 1, at 323. Section 201 contains two categories of exemptions not included in the Uniform Act: section 201(12), exempting securities of Mississippi cooperatives, and section 201(13), exempting certain oil and gas securities. *See id.* at 324; *infra* notes 68 and 72 and accompanying text. The section 201 exemptions are also similar to those granted by section 3(a) of the 1933 Securities Act. 15 U.S.C. § 77c(a) (1994 & Supp. V 1999).

[54] MISS. CODE ANN. § 75-71-201(1); *see, e.g.,* Pac. Crest Inv. & Loan, 1996 Miss. Sec. LEXIS 1, at *1 (Dec. 17, 1996) (FDIC-insured deposits); Foothill Thrift Loan, 1989 Miss. Sec. LEXIS 13, at *1 (May 3, 1989) (same); Gulf Oil Corp.

litical subdivision of a state, or an agency or instrumentality of a state;[55] (3) a foreign government with which the United States currently maintains diplomatic relations;[56] (4) a federal credit union or a credit union, industrial loan association, or similar association organized under the laws of Mississippi;[57] or (5) a railroad, other common carrier, public utility, or public utility holding company.[58]

Section 201 also exempts most securities issued by:[59] (6) a national bank[60] or federal savings and loan association;[61] (7) a state bank,[62] savings institution,[63] or trust company[64]

Savs.–Stock Bonus Plan, 1985 Miss. Sec. LEXIS 2, at *1 (Feb. 19, 1985) (U.S. savings bonds). *See generally* Parsons, *supra* note 1, at 188.

[55] MISS. CODE ANN. § 75-71-201(1); *see, e.g.,* Va. Higher Educ. Tuition Trust Fund, 1996 Miss. Sec. LEXIS 3, at *1 (Sept. 5, 1996); Certificates of Participation, 1993 Miss. Sec. LEXIS 2, at *1 (Aug. 4, 1993); Stonegate Village Metro. Dist., 1992 Miss. Sec. LEXIS 3, at *1 (Apr. 16, 1992); S. Cal. Pub. Power Auth. Transmission Project Revenue Bonds, 1991 Miss. Sec. LEXIS 6, at *1 (Apr. 16, 1991); Salt Lake City, Utah Flexible Rate Revenue Bonds, Series 1990, 1990 Miss. Sec. LEXIS 12, at *1 (Jan. 8, 1990); Pa. Higher Educ. Assistance Agency, 1989 Miss. Sec. LEXIS 27, at *1 (Sept. 7, 1989); Mich. Educ. Trust, 1989 Miss. Sec. LEXIS 10, at *16 (Feb. 1, 1989). *See generally* Parsons, *supra* note 1, at 188.

[56] MISS. CODE ANN. § 75-71-201(2).

[57] *See id.* § 75-71-201(6).

[58] *Id.* § 75-71-201(7); *see, e.g.*, Duquesne Light Co., 1987 Miss. Sec. LEXIS 42, at *1 (Nov. 9, 1987); Ohio Edison Co. Collateralized Lease Bonds, 1987 Miss. Sec. LEXIS 25, at *1 (May 18, 1987); Niagara Mohawk Power Corp. Secured Facility Bonds, 1987 Miss. Sec. LEXIS 16, at *1 (Apr. 1, 1987). *See generally* Parsons, *supra* note 1, at 191.

[59] Notice the distinction here: sections 201(1), (2), (6), and (7) exempt securities "issued or guaranteed by" a listed entity; whereas, sections 201(3), (4), (5), and (9) exempt only securities "issued by" a listed entity and section 201(12) exempts only securities "of" a listed entity. *See* MISS. CODE ANN. § 75-71-201. The difference is more than semantic. *See, e.g.*, City of Redding Certificates of Participation, 1986 Miss. Sec. LEXIS 12, at *1 (Feb. 28, 1986) (refusing to recognize section 201(5) exemption for certificates guaranteed by Financial Guaranty Insurance Company ("FGIC") because "FGIC is not the issuer").

[60] *See* MISS. CODE ANN. § 75-71-201(3); *see also* Tender Options on State & Local Gov't Bonds, 1990 Miss. Sec. LEXIS 13, at *1 (Jan. 9, 1990); Wells Fargo Inv. Trust, 1987 Miss. Sec. LEXIS 26, at *1 (May 18, 1987); Offer and Sale of Short Term Promissory Notes, 1986 Miss. Sec. LEXIS 5, at *1 (Jan. 31, 1986). *See generally* Parsons, *supra* note 1, at 188.

[61] MISS. CODE ANN. § 75-71-201(4); *see, e.g.,* First Fed. Savs. & Loan Assoc., 1988 Miss. Sec. LEXIS 17, at *1-3 (May 3, 1988); Home Fed. Savs. & Loan Assoc., 1987 Miss. Sec. LEXIS 52, at *1-3 (Dec. 15, 1987); First Fed. Savs. & Loan Assoc., 1987 Miss. Sec. LEXIS 11, at *1-3 (Feb. 19, 1987). *See generally* Parsons, *supra* note 1, at 189.

[62] MISS. CODE ANN. § 75-71-201(3); *see, e.g.,* Bank of Commerce, 1985 Miss.

organized and supervised under the law of any state; (8) a savings and loan, building and loan, or similar association organized and supervised under the law of any state and authorized to do business in Mississippi;[65] (9) an insurance company authorized to do business in Mississippi;[66] (10) a non-profit, religious, charitable, or benevolent corporation;[67] or (11) a cooper-

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Sec. LEXIS 21, at *1-5 (Dec. 4, 1985). *See generally* Parsons, *supra* note 1, at 188.

[63] MISS. CODE ANN. § 75-71-201(3); *see, e.g.,* Imperial Thrift & Loan Assoc., 1996 Miss. Sec. LEXIS 4, at *1 (Oct. 22, 1996). *See generally* Parsons, *supra* note 1, at 188.

"The term 'savings institution' refers to a type of financial institution prevalent in the Northeast and not to savings and loan associations in general." *In re* Sav. Inst. Sec. Exemption, 1986 Miss. Sec. LEXIS 8, at *1-2 (Feb. 4, 1986). *See generally* Parsons, *supra* note 1, at 189.

[64] MISS. CODE ANN. § 75-71-201(3). *See generally* Parsons, *supra* note 1, at 188.

[65] MISS. CODE ANN. § 75-71-201(4). *See generally* Parsons, *supra* note 1, at 189.

The Mississippi Business Services Division has previously indicated its willingness to extend the section 201(4) exemption to, *inter alia*, notes issued by an agricultural cooperative marketing association and agricultural credit corporation, organized and authorized to do business in Mississippi, on the theory that it was "similar" to a savings and loan association. *See* Staple Cotton Disc. Corp., 1987 Miss. Sec. LEXIS 41, at *1-5 (Nov. 9, 1987). *See generally* Parsons, *supra* note 1, at 189. However, the Division has indicated its unwillingness to extend the section 201(4) exemption to savings and loans not authorized to do business in Mississippi. *See, e.g.*, Sav. Inst. Sec. Exemption, 1986 Miss. Sec. LEXIS 8, at *1 (Feb. 4, 1986) ("The exemption relevant to your situation is found in section 75-71-201(4) and would require domestication by your company in this State in order to take advantage of the exemption."); Offering of Subordinated Capital Notes, 1985 Miss. Sec. LEXIS 17, at *1 (Aug. 23, 1985) ("Savings and loan associations such as Commonwealth must be authorized to do business in Mississippi before its securities are entitled to an exemption.").

[66] *See* MISS. CODE ANN. § 75-71-201(5); *see, e.g.,* P-I-E Mut. Ins. Co., 1992 Miss. Sec. LEXIS 5, at *1 (Dec. 10, 1992); VHA Ins. Co., 1987 Miss. Sec. LEXIS 20, at *1-2 (May 7, 1987); *see also supra* note 59 and accompanying text. *See generally* Parsons, *supra* note 1, at 192.

[67] MISS. CODE ANN. § 75-71-201(9); *see, e.g.,* Health Choice of Miss., Inc., 1995 Miss. Sec. LEXIS 1, at *1 (June 12, 1995); The Gen. Council of the Assemblies of God, 1993 Miss. Sec. LEXIS 1, at *1 (Oct. 8, 1993); Pooled Income Fund, 1989 Miss. Sec. LEXIS 29, at *1 (Sept. 19, 1989).

In addition to more traditional non-profit, charitable and religious issuers, the Business Services Division has determined that section 201(9) extends to non-profit corporate trade organizations. *See* Collision Auto. Repair Servs., Inc., 1992 Miss. Sec. LEXIS 14, at *1-2 (Sept. 29, 1992).

ative organized under the laws of Mississippi, owned solely by residents of Mississippi, and operating wholly within the state.[68] Other exempt securities include: (12) any security listed or approved for listing on the American, Boston, Chicago, Cincinnati, Midwest, New York, Pacific, or Philadelphia Stock Exchange, or the Chicago Board Options Exchange;[69] (13) short-term promissory notes issued by commercial entities;[70] (14) investment contracts issued in connection with an

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[68] MISS. CODE ANN. § 75-71-201(12); *see, e.g.,* Timber Producers Corp., 1988 Miss. Sec. LEXIS 24, at *1-3 (July 6, 1988).

[69] MISS. CODE ANN. § 75-71-201(8); Rule 707, Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,531, at 29,426; *see, e.g.*, Cent. Vt. Pub. Serv. Corp., 1992 Miss. Sec. LEXIS 2, at *1 (Nov. 10, 1992); AIG Liquidity Corp., 1992 Miss. Sec. LEXIS 1, at *1 (July 9, 1992); Niagara Mohawk Power Corp., 1987 Miss. Sec. LEXIS 16, at *1 (April 1, 1987); Clabir Corp., 1986 Miss. Sec. LEXIS 35, at *1-4 (Dec. 30, 1986); Sunshine Mining Co., 1986 Miss. Sec. LEXIS 28, at *1-4 (Oct. 1, 1986); Eastman Kodak Co., 1986 Miss. Sec. LEXIS 4, at *1 (Jan. 27, 1986); *see also infra* note 94 and accompanying text. *See generally* Securities, Broker-Dealer Registration, and Trade Exemptions, 1994 Miss. Sec. LEXIS 5, at *1-2 (Sept. 7, 1994) (noting section 75-71-201(8) exempts securities under certain stock exchanges and listed under Rule 707).

[70] MISS. CODE ANN. § 75-71-201(10); *see, e.g., In re* Stewart, No. 97-05-59, 1998 Miss. Sec. LEXIS 3, at *14 (Aug. 27, 1998); *see also, e.g.*, State v. Russell, 358 So. 2d 409, 411-12 (Miss. 1978) (applying parallel exemption in former Mississippi Securities Law, MISS. CODE ANN. § 75-71-51(8) (1972), *repealed by* 1981 Miss. Laws, ch. 521, § 418).

This exemption "applies only to prime quality negotiable commercial paper of a type not ordinarily purchased by the general public, that is, paper issued to facilitate well recognized types of current operational business requirements," and is only available to an offeror or seller who can establish that the instrument (1) is negotiable, (2) is of prime quality, (3) is not ordinarily purchased by the general public, (4) is used to facilitate current transactions, and (5) matures in nine months or less and does not automatically roll-over. *Stewart*, 1998 Miss. Sec. LEXIS 3, at *15-17. In *Stewart*, the Business Services Division concluded the promissory notes at issue were not entitled to the commercial paper exemption because they were not of "prime quality." *Id.* at *17. It stated:

> The issuer of the notes in this case, FLIC, was certainly not a seasoned or secure corporation . . . It was incorporated in Florida in April of 1995 and began issuing these promissory notes as early as eleven months thereafter. Within three years of its inception, FLIC was in bankruptcy. So, FLIC was not only unseasoned, but on the brink of bankruptcy during the period it issued the promissory notes. Clearly, under these circumstances, any promissory note it issued would not garner the title "prime quality" for the purposes of the commercial paper exemption.
>
> Evidently, FLIC itself was not convinced of the quality of the notes, because there is no indication that it sought a rating from one of the

employee stock purchase, savings, pension, profit-sharing, or similar plan;[71] and (15) oil, gas, and mineral leases, working interests, mineral or royalty interests or estates or an oil payment or net profit interest, provided the working interest is not less than 1/200th of the whole working interest, and any mineral lease or royalty sales are granted in exchange for labor, materials, or machinery used in drilling an oil or gas well.[72]

Section 401 was amended in 1997 to also exempt from MSA registration "federal covered securities"[73] not otherwise exempt under section 201 or 203.[74] The MSA authorizes the Secretary of State to require the filing of certain documents and the payment of certain fees relating to federally covered securities.[75] However, the section 401 exemption is not premised on compliance with section 408. Therefore, no civil registration liability should attach to the offer or sale of federal covered securities even if the issuer, offeror or seller violates section 408.

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established institutions which rate commercial paper such as Standard & Poor's, Dunn & Bradstreet or Moody's. Even if it had sought such a rating, nothing in the record indicates that any of these companies actually rated the FLIC promissory note offering.

Hence, FLIC's lack of an established history of operations and its financial insecurity during the offering period, prevents any finding other than that these notes are not prime quality. Thus, they are not commercial paper, and are, therefore, not exempt from the registration requirements of the Act.

Id. at *19-21.

[71] MISS. CODE ANN. § 75-71-201(11); *see, e.g.,* Nissan Motor Corp. Employee Savs. Plan, 1993 Miss. Sec. LEXIS 3, at *1 (Nov. 29, 1993); Regan Holding Corp., 1991 Miss. Sec. LEXIS 9, at *1 (Dec. 16, 1991); Int'l Family Entm't, Inc., 1990 Miss. Sec. LEXIS 19, at *1 (Mar. 26, 1990); The Loewen Group, Inc., 1990 Miss. Sec. LEXIS 18, at *1 (Feb. 13, 1990); PCL Indus. Ltd., 1989 Miss. Sec. LEXIS 25, at *1-2 (Aug. 5, 1989); MCI Communications Corp., 1988 Miss. Sec. LEXIS 21, at *1-3 (June 10, 1988); Gulf Oil Corp. Savs., 1985 Miss. Sec. LEXIS 2, at *1 (Feb. 19, 1985). *See generally* Parsons, *supra* note 1, at 189; Vaaler, *supra* note 1, at 349-51 (discussing exemption of employer securities offered or sold pursuant to employee plans).

[72] MISS. CODE ANN. § 75-71-201(13); *see, e.g.,* Physicians Drilling Group, 1988 Miss. Sec. LEXIS 33, at *1-2 (Sept. 28, 1988).

[73] *See supra* note 51 and accompanying text (discussing securities exempt from registration).

[74] MISS. CODE ANN. § 75-71-401.

[75] *See id.* § 75-71-408.

b. Exempt Transactions

Section 203 of the MSA identifies certain sales, offerings for sale, solicitations, subscriptions, dealings in, and deliveries of securities that—due to the nature of the transaction, the nature of the parties, or both—are exempt from the MSA's registration requirements;[76] and, therefore, will not give rise to registration liability.[77] Section 203 exempts from registration most: (1) isolated nonissuer transactions;[78] (2) nonissuer distributions of outstanding securities of issuers for which certain information is contained in a recognized securities manual;[79] (3) nonissuer distributions of outstanding securities with

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[76] *Id.* § 75-71-203. The section 203 exemptions generally track those contained in section 402(b) of the 1956 Uniform Securities Act, 7C U.L.A. 219, 219-21 (2000). Mississippi's preorganization certificate or subscription exemption is noticeably more generous than the Uniform Act's, allowing up to thirty-five subscribers, as opposed to ten. *Compare* MISS. CODE ANN. § 75-71-203(10) (allowing up to thirty-five subscribers) *with* Uniform Securities Act § 402(b)(10), 7C U.L.A. at 220 (allowing only ten subscribers). The section 203 exemptions are also similar to those granted by section 4 of the 1933 Securities Act, 15 U.S.C. § 77d (1994), although both the MSA and the Uniform Act provide a number of transactional exemptions not provided by section 4.

[77] MISS. CODE ANN. § 75-71-401, -717(a)(1). Neither the transactional exemptions in section 203 nor securities exemptions in section 201 affect the liability of anyone who offers to sell or sells securities in violations of the MSA's anti-fraud provisions. *See infra* note 109 and accompanying text.

[78] MISS. CODE ANN. § 75-71-203(1). *See generally In re* Securities, Broker-Dealer Registration, and Trade Exemptions, 1994 Miss. Sec. LEXIS 5 (Sep. 7, 1994).

[79] MISS. CODE ANN. § 75-71-203(2)(A); *see* Rule 709, Miss. Blue Sky Regs., *reprinted in* 2A BLUE SKY L. REP. (CCH) ¶ 34, 352, at 29,426 (identifying eight "recognized securities manuals"); Mergent's Manuals Rule Change, 2001 Miss. Sec. LEXIS 7, *1 (Apr. 17, 2001) (recognizing the sufficiency, for purposes of Rule 709, of "information . . . published in Mergent's Manuals or CD-ROMs, or disseminated by Mergent's FIS, Inc. electronically over the Internet"); *see, e.g.*, Shivangi v. Dean Witter Reynolds, Inc., 107 F.R.D. 313, 322 (S.D. Miss. 1985); AM Swiss Pharm., Inc., 1989 Miss. Sec. LEXIS 8 (Jan. 11, 1989); Leeds Capital Corp., 1988 Miss. Sec. LEXIS 15 (Feb. 22, 1988); FONAR Corp., 1987 Miss. Sec. LEXIS 17 (Apr. 21, 1987); Elders IXL Ltd., 1987 Miss. Sec. LEXIS 23 (May 13, 1987).

In *Redland Preferred Stock PLC*, 1989 Miss. Sec. LEXIS 35 (Nov. 20, 1989), the Business Services Division found that section 203(2)(A) did not exempt from registration shares of an issuer for whom the required fiscal year financial information was lacking, despite the fact that a recognized securities manual included all other required information about the issuer and all required information about the issuer's parent.

a fixed maturity or fixed interest or dividend;[80] (4) unsolicited nonissuer orders or offers to buy executed by or through registered broker-dealers;[81] (5) transactions between issuers and underwriters or among underwriters;[82] (6) transactions in bonds or other evidences of indebtedness secured by a mortgage or deed of trust on real or chattel property;[83] (7) transactions by executors, administrators, receivers, trustees in bankruptcy, guardians, or conservators;[84] (8) transactions executed by a bona fide pledgee;[85] (9) offers or sales to a bank, savings institution, trust company, pension fund, profit-sharing trust, other financial institution, insurance company, investment company, broker-dealer, or institutional buyer;[86] (10) sales made by an issuer, without public solicitation or advertisement, for no commission, which sold its securities during the preceding twelve months to not more than ten persons who bought for their own account;[87] (11) transactions involving preorganization certifi-

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[80] MISS. CODE ANN. § 75-71-203(2)(B).

[81] *Id.* § 75-71-203(3).

[82] *Id.* § 75-71-203(4).

[83] *Id.* § 75-71-203(5); *see, e.g.*, 1987 Miss. Sec. LEXIS 12 (Feb. 19, 1987).

[84] MISS. CODE ANN. § 75-71-203(6); *see, e.g.*, Paradyne Corp., 1987 Miss. Sec. LEXIS 22 (May 13, 1987).

[85] MISS. CODE ANN. § 75-71-203(7); *see, e.g.*, OmniBank of Mantee, 1990 Miss. Sec. LEXIS 10 (Sept. 26, 1990).

[86] MISS. CODE ANN. § 75-71-203(8); *see, e.g.*, Prudential Sec. Inc., 1995 Miss. Sec. LEXIS 3 (Oct. 12, 1995); Corporate Network Brokerage Servs., Inc., 1994 Miss. Sec. LEXIS 2 (May 13, 1994); *see also* Rule 103(G), Miss. Blue Sky Regs., *reprinted in* 2A BLUE SKY L. REP. (CCH) ¶ 34,403, at 29,401 (2001) (defining, *inter alia*, "Institutional Buyer"). *See generally* Vaaler, *supra* note 1, at 327-32.

[87] MISS. CODE ANN. § 75-71-203(9); *see, e.g.*, Gulfport Out-Patient Surgical Ctr., Ltd., 1992 Miss. Sec. LEXIS 6 (June 8, 1992); Union Compress Warehouse Co., L.P., 1988 Miss. Sec. LEXIS 28 (Sep. 7, 1988). *See generally* Parsons, *supra* note 1, at 189-90; Vaaler, *supra* note 1, at 332-37.

The ten person limit in section 203(9) "applies to the whole transaction, not just ten persons in the State of Mississippi." Concord Growth Corp., 1988 Miss. Sec. LEXIS 4, at *1 (Jan. 11, 1988). A husband and wife who purchase a security jointly are a single purchaser for purposes of section 203(9). *See* 1988 Miss. Sec. LEXIS 37, at *1 (Oct. 12, 1988). This exemption is self-effecting. *See* Rule 701, Miss. Blue Sky Regs., *reprinted in* 2A BLUE SKY L. REP. (CCH) ¶ 34,521, at 29,424 (2001).

The Business Services Division has the power, under both section 203(9) and section 203(13), to waive strict compliance with section 203(9). *See* MISS. CODE ANN. § 75-71-203(9), (13); *infra* text accompanying note 91. It has, at various times, chosen to exercise that power and to refrain from doing so. *Compare, e.g.*,

cates or subscriptions;[88] (12) transactions pursuant to a no-

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Centech Labs., Inc., 1996 Miss. Sec. LEXIS 5 (July 1, 1996) (waiving ten-person limit), Gentry Gowns, Inc., 1991 Miss. Sec. LEXIS 12 (July 12, 1991) (waiving no-commission requirement), and Sabre Indus., Inc., 1991 Miss. Sec. LEXIS 11 (Jan. 16, 1991) (same), *with, e.g.*, Concord Growth Corp., 1989 Miss. Sec. LEXIS 11 (Feb. 24, 1989) (declining to waive either the ten-person limit or no-commission requirement).

[88] MISS. CODE ANN. § 75-71-203(10). *See generally* Vaaler, *supra* note 1, at 337-38. This exemption appears not to extend to offers pursuant to a merger or other corporate reorganization. First State Bank, 1985 Miss. Sec. LEXIS 3 (Feb. 21, 1985). Those transactions, however, are effectively exempted by section 105(1)(6)(C), which treats them as outside of the definition of "sale" or "offer to sell." *See* MISS. CODE ANN. § 75-71-105(1)(6)(C); *supra* note 46.

In *Russell v. Southern National Foods, Inc.*, 754 So. 2d 1246 (Miss. 2000), the Mississippi Supreme Court held that the MSA does not require registration of preorganization subscriptions, at least so long as the subscribers can be characterized as "insiders":

> The appellants assert that the trial court erred in its application of the law when it relied on *Guynn v. Shulters*, 223 Miss. 232, 78 So. 2d 114 (1955). *Guynn* held that preincorporation stock certificates did not have to be registered if they were sold to the incorporators of a "to be formed" corporation. . . .
>
> The appellants proceed on the theory that *Guynn* predates the current Blue Sky statutes, and thus the case has no application. Appellants' main contention is that the Mississippi Code of 1942 has been repealed or superceded by the Mississippi Securities Act of 1981, and thus *Guynn* contradicts the current securities regulations. . . .
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> . . . .
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> . . . In *Ayers v. Wolfinbarger*, 491 F.2d 8 (5th Cir. 1974), the court stated the acquisition of the original issue of stock was nothing more than organizational stock. The sale of stock to the promoters was a private offering and, therefore, exempt from the registration requirements of the Federal Securities Act.
>
> In *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953), the Court held the applicability of the registration requirement in the federal Securities Act should turn on whether the particular class of persons affected need the protection of the Act. As this Court held in *Guynn* and the chancellor also ruled here, the appellants did not need the protection of the Mississippi Securities Act nor was it the statute's intent to afford this group protection.
>
> In summary, considering the clear purpose of the Act is to protect the general public, the trial court found the appellants were "insiders." Appellants were appraised of all material data, and they had access to information. There was a limited number of subscribers, having a privileged relationship with the corporation. Their present knowledge, involvement in forming the corporation, and ability to acquire information would not afford them protection under the Act. *Guynn* is not overruled.

Id. at 1249-52 (citations omitted).

commission offer to existing securities holders of the issuer who also hold convertible securities, nontransferable warrants, or short-term transferable warrants;[89] and (13) non-sale offers of securities registered under both the MSA and the 1933 Securities Act for which no stop order or refusal order is in effect and no public proceeding for such order is underway.[90]

Section 203 also empowers the Secretary of State to exempt from registration otherwise non-exempt securities if the Secretary finds that "(A) such registration is neither necessary in the public interest nor for the protection of investors; or (B) such exemption shall further the objectives of compatibility with federal exemptions and uniformity among the states."[91] Pursuant to that authority, the Secretary of State has (1) adopted the Uniform Limited Offering Exemption;[92] (2) exempted domestic issuer private placements to not more than thirty-five (35) persons within a twelve (12) month period;[93] (3) in essence, extended the section 201(8) exchange-listed securities exemption to NASDAQ National Market System securities;[94] (4) adopted an Internet solicitation exemption;[95] (5) expanded the exemption already afforded by section 201(12)

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[89] MISS. CODE ANN. § 75-71-203(11); *see, e.g.*, Affiliated Research Ctrs., Inc., 1996 Miss. Sec. LEXIS 13 (Sept. 16, 1996); Eastco Indus. Safety Corp., 1996 Miss. Sec. LEXIS 6 (Aug. 23, 1996); Commercial Nat'l Fin. Corp., 1989 Miss. Sec. LEXIS 34 (Nov. 10, 1989); Tex. Am. Group, Inc., 1989 Miss. Sec. LEXIS 28 (Sept. 13, 1989); Sun Equities Corp., 1988 Miss. Sec. LEXIS 34 (Oct. 5, 1988); Bucyrus-Erie Co., 1988 Miss. Sec. LEXIS 29 (Sept. 14, 1988); VMS Strategic Land Fund II, 1988 Miss. Sec. LEXIS 26 (Aug. 29, 1988). *See generally* Parsons, *supra* note 1, at 190-91; Vaaler, *supra* note 1, at 347-49.

[90] MISS. CODE ANN. § 75-71-203(12).

[91] *Id.* § 75-71-203(13).

[92] Rule 703, Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,522, at 29,424 (2001); *see, e.g.*, ROMAXSCO Exploration Co., 1987 Miss. Sec. LEXIS 36 (Sept. 14, 1987). *See generally* Vaaler, *supra* note 1, at 338-44.

[93] Rule 705, Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,523, at 29,426; *cf.* Physicians Drilling Group, 1988 Miss. Sec. LEXIS 33 (Sept. 28, 1988) (discussing Rule 705, but advising that it is only available to domestic issuers). *See generally* Vaaler, *supra* note 1, at 344-47.

[94] Rule 711, Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,534, at 29,428 (2001). *See generally* Securities, Broker-Dealer Registration, and Trade Exemptions, 1994 Miss. Sec. LEXIS 5, at *1-2 (Sept. 7, 1994).

[95] Rule 713, Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,536, at 29,428 (2001).

to cooperative securities;[96] and (6) exempted from registration the offer for sale and sale of certain viatical settlement investment contracts.[97]

2. *Primary Liability for Selling Unregistered Securities*

Section 717(a)(1) entitles a buyer to sue "any person who offers or sells a security in violation of Section . . . 75-71-401."[98] Section 717(a)(1), like its federal counterpart, section 12(a)(1) of the 1933 Securities Act,[99] is essentially a "strict liability" statute.[100] As long as the plaintiff can establish that the security was unregistered at the time of the sale, the defendant will be liable, unless the defendant can establish that the security or the transaction itself was exempt from registration.[101]

3. *Defenses to Registration Liability*

a. *Standing*

Section 717(a)(1)'s protection extends only to buyers.[102] A

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[96] Rule 715, Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,538, at 29,429 (2001).

[97] Rule 902, Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,572, at 29,432 (2001).

[98] MISS. CODE ANN. § 75-71-717(a)(1) (2000).

[99] 15 U.S.C. § 77*l*(a)(1) (Supp. V 1999); *see supra* note 10.

[100] *See, e.g.*, Hill York Corp. v. Am. Int'l Franchises, Inc., 448 F.2d 680, 686 (5th Cir. 1971) (holding that plaintiff may recover under what is now section 12(a)(1) "regardless of whether he can show any degree of fault, negligent or intentional, on the seller's part"); *accord* Swenson v. Engelstad, 626 F.2d 421, 444-45 (5th Cir. 1980).

[101] MISS. CODE ANN. § 75-71-207; *see* Blinder, Robinson & Co., 1990 Miss. Sec. LEXIS 14, at *1 (Jan. 17, 1990); Staple Cotton Disc. Corp., 1987 Miss. Sec. LEXIS 41, at *1 (Nov. 9, 1987).

[102] MISS. CODE ANN. § 75-71-717(a)(1) ("Any person who offers or sells a security in violation of section . . . 75-71-401 . . . is liable to the person buying the security from him . . . ."); *see, e.g.*, Fortenberry v. Foxworth Corp., 825 F. Supp. 1265, 1279 (S.D. Miss. 1993) ("[O]nly purchasers of securities can bring an action under § 717.").

What, exactly, makes one a "buyer" is less than clear. The term is undefined in the MSA and has not been the subject of any reported Mississippi case. Construing an analogous provision of the 1933 Securities Act, a federal district court held that a plaintiff did not have to be an owner to be considered the purchaser, but had to have "sufficient indicia of ownership to effectuate a tender of the secu-

person who did not purchase a security lacks standing to sue the person who sold it for failing to register properly the security.

b. Limitations

A purchaser must bring any claim for a violation of the MSA's registration provisions within two years of the date of sale.[103] This limitations period is unaffected by the plaintiff's failure to discover the violation or by any form of equitable tolling.[104]

c. Waiver

The MSA prohibits any attempt by the parties to a transaction subject to the MSA to waive the MSA's requirements.[105]

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rities." Monetary Mgmt. Group, Inc. v. Kidder, Peabody & Co., 604 F. Supp. 764, 768 (E.D. Mo. 1985) (holding that person must be "purchaser" within meaning of securities statutes to be real party in interest). The plaintiff in *Monetary Management Group* purchased the bonds in question for a customer, and the court found this sufficient to establish the plaintiff as the purchaser and as the proper party to bring an action for rescission. *Id.* at 767. A Texas Court of Appeals, construing the analogous provision of the Texas Securities Act, TEX. REV. CIV. STAT. ANN. art. 581-33A(1) (West Supp. 2000), found "sufficient indicia of ownership" where the plaintiff "negotiated with the control persons for the purchase of [the] stock and was the record holder of the stock," despite uncertainty as to the source of the funds to make the purchase. Summers v. WellTech, Inc., 935 S.W.2d 228, 233 (Tex. App. 1996).

[103] *See* MISS. CODE ANN. § 75-71-725. By comparison, claims for violations of section 12(a)(1) of the 1933 Securities Act must be brought within one year of their occurrence, but in any event within three years of the first bona fide offer of the security to the investing public. *See* 15 U.S.C. § 77m. Thus, the MSA generally affords Mississippi plaintiffs a more generous period of time within which to bring suit over the sale of unregistered and non-exempt securities than they are afforded by section 12(a)(1).

[104] Likewise, equitable tolling may not extend limitations for a section 12(a)(1). *See* Gardner v. Investors Diversified Capital, Inc., 805 F. Supp. 874, 878 (D. Colo. 1992) (finding that plaintiffs had failed to file complaint within one year statute of limitations).

[105] MISS. CODE ANN. § 75-71-729 (invalidating any "condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of th[e MSA] or any rule or order hereunder"). The MSA's anti-waiver provision is essentially the same as the comparable federal provision. *See* 15 U.S.C. § 77n (1994) ("Any condition, stipulation, or provision binding any person

d. Other Defenses (or Lack Thereof)

In contrast to the MSA's antifraud provisions,[106] neither the buyer's knowledge of the offense nor the seller's lack of knowledge is a defense to liability under section 717. Likewise, equitable defenses such as estoppel, laches, waiver, *in pari delicto*, ratification, and unclean hands, which may apply to common law or statutory claims arising out of a defendant's material misrepresentations or omissions regarding a securities transaction,[107] do not apply to claims arising out of a defendant's violation of the registration provisions of the MSA.[108] Therefore, in the absence of a standing or limitations defense, a primary violator will be strictly liable.

C. Statutory Liability for Material Misrepresentations or Omissions in an Offer or Sale of Securities

Irrespective of any exemption from registration,[109] the MSA imposes liability on those who offer to sell or sell securities by means of any written or oral communication:
(1) containing an untrue statement of material fact, or
(2) omitting a material fact necessary to make those statements that were made, in light of the circumstances in which they were made, not misleading, *unless:*
(3) the seller can prove:

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acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.").

Section 729 does not apply to, and therefore should not diminish the effectiveness of, a bona fide release or settlement of an existing claim, whether or not a suit has been filed. *See* Murtagh v. Univ. Computing Co., 490 F.2d 810, 816 (5th Cir.) (construing parallel provision in 1933 Securities Act).

[106] *See infra* Part II.C.6.c.i-ii.

[107] *See infra* note 148.

[108] *See generally* Hall v. Johnston, 758 F.2d 421, 423 (9th Cir. 1985) (applying analogous provision of Oregon Securities Law, OR. REV. STAT. § 59.115(1)(a) (1999)).

[109] *Compare* MISS. CODE ANN. § 75-71-717(a)(2) ("Any person who . . . offers or sells a security . . . .") *with id.* § 75-71-717(a)(1) ("Any person who offers or sells a security in violation of section 75-71-117(a), 75-71-301, or 75-71-401 . . . ."). The only requirement for section 717(a)(2) to apply is that the device or transaction be a "security" for purposes of section 105(n). *See supra* Part II.A.1.

(a) that she did not know, nor could she have known in the exercise of reasonable care, of the untruth or omission, or

(b) that the buyer actually knew of the untruth or omission before purchasing the securities.[110]

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[110] MISS. CODE ANN. § 75-71-717(a)(2). Section 717(a)(2) parallels section 12(a)(2) of the 1933 Securities Act, which makes liable any person who

> offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.

15 U.S.C. § 77*l*(a)(2) (Supp. V 1999). Section 717(a)(2) is broader than section 12(a)(2) in two important ways. First, section 717(a)(2) does not limit its reach to only those securities sold "by the use of any means or instruments of transportation or communication in interstate commerce or of the mails." Second, section 717(a)(2) does not limit its reach to only those securities sold "by means of a prospectus or oral communication."

The MSA contains another anti-fraud provision prohibiting material misrepresentations or omissions in the offer or sale (as well as the purchase) of securities. Section 501 declares it

> unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly,
>
> (1) To employ any device, scheme or artifice to defraud;
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or
>
> (3) To engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person.

MISS. CODE ANN. § 75-71-501; *see, e.g.*, Felts v. Nat'l Account Sys. Ass'n, 469 F. Supp. 54, 65-66 (N.D. Miss. 1978) (applying precursor to section 501, section 43 of former Mississippi Securities Law, MISS. CODE ANN. § 75-71-43 (1972), *repealed by* 1981 Miss. Laws, ch. 521, § 418, and finding that issuer "engaged in acts, practices and a course of business which operated as a fraud and a deceit and employed deceptive devices, artifices and schemes to defraud the plaintiffs in violation of," *inter alia*, former section 43(b)).

Section 501 is similar to Rule 10b-5(b), promulgated under section 10(b) of the 1934 Securities Exchange Act, 15 U.S.C. § 78j(b) (1994), and declaring it unlawful for any person . . .

> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the

The buyer bears the burden of proving either a material misrepresentation or omission.[111] The seller bears the burden of proving either her own diligent lack of knowledge or the plaintiff's actual knowledge.[112]

1. Form of Misrepresentation

Silence can be a form of misrepresentation for purposes of section 717(a)(2),[113] as can an incomplete statement, where what remains unsaid is material.[114] An opinion may be actionable under section 717(a)(2) if the speaker did not actually hold the opinion at the time she expressed it or if she expressed it knowing that it was misleadingly incomplete.[115]

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light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5(b) (2000). While an integral part of criminal and administrative enforcement of the MSA, section 501 is of no particular relevance to our discussion because the Mississippi Supreme Court has held that it gives rise to no private cause of action. *See* Allyn v. Wortman, 725 So. 2d 94, 102 (Miss. 1998) (holding that no private cause of action is implied from section 17(a) of Securities Act of 1933, and therefore none exists for nearly identical state statute).

[111] *See, e.g.*, Russell v. S. Nat'l Foods, Inc., 754 So. 2d 1246, 1254 (Miss. 2000) (finding summary judgment proper when party fails to establish facts supporting claim of misrepresentation).

[112] *See infra* Parts II.C.6.c.ii & II.C.6.c.i, respectively.

[113] MISS. CODE ANN. § 75-71-717(a)(2) (2000) (establishing liability for, *inter alia*, offering to sell or selling securities by use of written or oral communication which "omi[ts] to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading"); *see, e.g.*, *In re* J. F. (Jim) Straw d/b/a Am. Bus. Club, No. 92-04-08, 1992 Miss. Sec. LEXIS 17, at *4 (Apr. 17, 1992) (finding a material omission where offering materials "[f]ailed to state that the average period of time which an investor must wait to receive [the promised benefit] is two years").

[114] *See, e.g.*, *In re* BMT Racing Stables, No. CD 86-8-1, 1986 Miss. Sec. LEXIS 1, at *2 (Sep. 10, 1986) (finding that offerors made material misrepresentation when their materials offering for purchase interests in thoroughbred race horses included photo of horse in which offerors had no interest to sell).

[115] *See* Va. Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1094-95 (1991) (finding opinion actionable under parallel federal law).

By comparison, it appears that Mississippi courts will not entertain a claim for common law fraud or negligent misrepresentation in the context of a securities transaction based on an opinion—whether truly held by the party expressing it or

Likewise, a promise may be actionable under section 717(a)(2) if the promisor made the promise for the purpose of inducing the promisee to purchase securities.[116]

A misrepresentation need not be made directly to the plaintiff to give rise to liability under section 717(a)(2).[117]

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not. *See* Guynn v. Shulters, 78 So. 2d 114, 122 (Miss. 1955) (holding that, in order to rescind stock purchase based on fraudulent inducement, buyer must show, *inter alia*, "that the statement was not uttered as an opinion, but as an ascertained and existing fact").

[116] *See, e.g.*, First Mobile Home Corp. v. Little, 298 So. 2d 676, 681 (Miss. 1974) (explicitly distinguishing actionability under MSA of promises made to induce purchase of securities from actionability of promises in general under Mississippi common law).

As a rule, Mississippi courts will not entertain common law fraud or negligent misrepresentation claims based on promises of future action—regardless of whether the promisor intended to keep his promise when he made it. *See, e.g.*, Spragins v. Sunburst Bank, 605 So. 2d 777, 780 (Miss. 1992) (holding that fraudulent misrepresentations must be related to past or present existing facts); *accord* R.C. Constr. Co. v. Nat'l Office Sys., Inc., 622 So. 2d 1253, 1256 (Miss. 1993) (concurring in ruling that misrepresentations cannot contain promise of future conduct).

[117] In this vein, the Mississippi Supreme Court has adopted the "fraud-on-the-market" theory, which dispenses with any requirement that the material misrepresentation or omission giving rise to the plaintiff's claim have been directed at the plaintiff.

> The fraud-on-the-market theory . . . protects the integrity of the market as a whole by ensuring that the market receives timely and accurate information. Since the goal of the fraud-on-the-market doctrine is to ensure a level playing field for all potential investors, a plaintiff need not show that he heard or relied on the misrepresentations. He need only show that the defendant's misrepresentation distorted the securities market price and that the plaintiff was relying on the integrity of the market to establish the genuine value of the securities by reflecting all material information available.

Allyn v. Wortman, 725 So. 2d 94, 101 (Miss. 1998) (citations omitted). Justice McRae excoriated the majority for adopting this theory in a case in which the majority admitted it did not apply on the facts. *See id.* at 104 (McRae, J., dissenting). No subsequent opinion of the Mississippi Supreme Court has gainsaid the *Allyn* majority's adoption of the theory.

A plaintiff suing for common law fraud would have to prove, *inter alia*, that the defendant intended for the plaintiff to act in reliance upon the misrepresentation or omission. *See infra* note 138. The defendant must have directed the misrepresentation or omission to the plaintiff, intending the plaintiff to act thereon; otherwise, the plaintiff's common law fraud claim will fail. *See, e.g.*, Levens v. Campbell, 733 So. 2d 753, 762 (Miss. 1999) (rejecting claim of fraud against person with whom plaintiff had never spoken); Boling v. A-1 Detective & Patrol Serv., Inc., 659

2. *Materiality*

For purposes of the MSA, an omission or misrepresentation is actionable only if it is material.[118] An omission or misrepresentation is material if it "would enable a prudent individual to make an informed investment decision."[119]

So. 2d 586, 590 (Miss. 1995) (stating fraud can never be presumed, but must be proven by clear and convincing evidence); Cook v. Children's Med. Group, P.A., 756 So. 2d 734, 744 (Miss. 1999) (Smith, J., concurring, joined by Cobb, J.) (refusing to adopt doctrine of imputed reliance). A plaintiff suing for common law negligent misrepresentation must show that, *inter alia*, the negligent misrepresentation was made to her. *See, e.g.*, Arnona v. Smith, 749 So. 2d 63, 67 (Miss. 1999).

The *Allyn* court was considering the doctrine in the context of a common law fraud claim—hence, the "reliance" language. *See infra* note 138 and accompanying text. It seems unfathomable that the court would recognize the theory in the context of a common law claim but not in the context of a section 717(a)(2) claim.

[118] *See* MISS. CODE ANN. § 75-71-717(a)(2). Materiality is also a requisite of liability under section 12(a)(2) of the 1933 Securities Act, *see supra* note 110, and section 10(b) of the 1934 Securities Exchange Act and Rule 10b-5 promulgated thereunder, *see id.*, as well as an element of both common law fraud, *see infra* note 138, and negligent misrepresentation, *see infra* note 139.

For purposes of section 12(a)(2) and section 10(b)/Rule 10b-5, information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether to buy or sell or how to vote the securities at issue. *See, e.g.*, TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976); Grossman v. Novell, Inc., 120 F.3d 1112, 1119 (10th Cir. 1997) (all holding that fact may be considered material if there is "substantial likelihood that a reasonable person would consider it important in deciding whether to buy or sell shares"); Azrielli v. Cohen Law Offices, 21 F.3d 512, 518 (2d Cir. 1994). The materiality standard for common law fraud and negligent misrepresentation appears to be more strict. While the cases requiring materiality for a claim of either fraud or negligent misrepresentation, or both, are legion, few if any bother to hint at the meaning of "materiality." From a review of the cases, it appears that the basic test of materiality for both common law fraud and negligent misrepresentation is whether the plaintiff would not have agreed to the transaction as structured "but for" the defendant's material misrepresentation or omission. *See, e.g.*, Holland v. Mayfield, No. 96-CA-01169-SCT, 1999 WL 353023, at *10 (Miss. June 3, 1999) (holding that defendant's misrepresentations were material for purposes of plaintiffs' common law fraud claims because "[a]lthough a couple of Investors testified that they were not sure if they would have invested . . . if they had known of the front-end payments, most testified that they definitely would not have invested if they had known.").

[119] Rule 103(I), Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,403, at 29,402. One might wonder if the "prudent individual" standard of materiality imposed by Rule 103(I) might be more difficult to establish than the "reasonable investor" standard under comparable federal law. Prudence might

In *Seaboard Planning Corp. v. Powell*,[120] decided under the precursor to section 717(a)(2),[121] Yates, a registered agent of defendant Seaboard, sold $20,000 worth of units in a real estate limited partnership to Powell. Powell was a 77-year-old farmer who "had never owned corporate stock," "did not know

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suggest more care than mere reasonableness. However, there is no indication in Mississippi case law—within or without the sphere of securities law—that prudent and reasonable are not synonymous.

In *New Amsterdam Casualty Co. v. Wood*, 57 So. 2d 141 (Miss. 1952), decided under the 1942 version of the MSA, MISS. CODE ANN. § 5360 (Supp. 1971), *codified as amended at* MISS. CODE ANN. § 75-71-1 (1972), *repealed by* 1981 Miss. Laws, ch. 521, § 418, the president of National Acceptance Corporation (NAC), Paul Schumpert, sold shares in NAC "by representations that payments for the stock sold would go into the capital structure of the corporation." *Wood*, 57 So. 2d at 142. In fact, Schumpert was selling his own shares and pocketing the proceeds. *See id.* at 142-43. He also purchased stock from other existing shareholders and resold it at a substantial profit—again representing to the buyers that the shares were being issued by NAC. *See id.* at 143. While the court was not asked to decide specifically whether Schumpert's representations were material, it did affirm the judgment against the surety (New Amsterdam), which was premised on Schumpert's violation of the precursor to section 717(a)(2). *See id.* at 144. In any event, it seems obvious that the fact that he was selling his own shares rather than the corporation's shares—suggesting that he might not have concerns about the future of the corporation—and the fact that the proceeds were going into his pocket rather than into the corporation—possibly affecting the corporation's ability to meet current obligations or to expand—are both facts that "would enable a prudent individual to make an informed decision" whether to buy the shares. As Chief Judge Clark wrote in another case where the source of the shares was misrepresented:

> By misrepresenting to Johnson that the stock was owned by an estate, and thus was available for sale due to the fortuity of a death, these defendants concealed that the chief executive officer of Mississippi Candies, although outwardly seeking financial capital for the financially plagued company, in fact, had chosen to divest himself of a portion of his investment in the corporation. In this context, the misstatement of the ownership of the securities offered for sale was a misrepresentation of material fact because there is a substantial likelihood that a reasonable investor would have considered the true ownership important in deciding on his course of action with respect to the transaction.

Johnson v. Yerger, 612 F.2d 953, 957 (5th Cir. 1980) (citations omitted).

[120] 364 So. 2d 1091 (Miss. 1978).

[121] Former section 75-71-25 entitled "[a]ny person or persons who shall be induced to purchase any stocks, bonds or other securities . . . by reason of any misrepresentation of any material facts concerning such stocks, bonds or other securities" to bring suit over such misrepresentation. MISS. CODE ANN. § 75-71-25 (1972) (repealed by Laws, 1981, ch. 521, § 418, as of July 1, 1981).

what a prospectus . . . was," and "had only a sixth grade education, and was totally unfamiliar with real estate . . . limited partnerships."[122] Powell initially asked Yates about buying bonds, but Yates discouraged Powell from buying bonds and recommended, on the advice of Seaboard *and without having read the prospectus himself*, the limited partnership interest.[123]

The limited partnership interests that Yates sold to Powell were designed for

> persons in higher federal income tax brackets, [who] by taking advantage of the depreciation provisions of the [IRS code] and regulations, produce considerable tax savings. . . . Persons in low income tax brackets generally do not profit from this type of partnership.[124]

Despite Powell's modest means,[125] Yates recommended the limited partnerships units because of their liquidity.[126]

After Powell received the first two quarterly dividend checks as promised, the third check was for half the amount promised, and was the last one forthcoming. Powell sought to cash out his investment, but found that "the securities had no established market and no cash-in value."[127] Powell and his wife sued Yates and Seaboard, and were awarded his $20,000 at trial. The Mississippi Supreme Court affirmed, finding ample evidence in the record to support a judgment based on Yates's material misrepresentations.[128]

In one of a number of related enforcement orders,[129] the

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[122] *Seaboard Planning*, 364 So. 2d at 1093-94.

[123] *See id.* at 1093-94.

[124] *Id.*

[125] *See id.* ("Yates knew that the year of the sale was the only year that Mr. Powell had anything to sell to create any substantial tax liability, and that in the next year Mr. Powell, in all likelihood, was going to be back in a low income tax bracket, but did not explain this to them.").

[126] *See id.* ("Yates told the Powells that he recommended this investment, and that this was a correct vehicle if Mr. Powell needed his money immediately.").

[127] *Id.* at 1094.

[128] *See id.* ("Yates never read the prospectus in full and failed to tell Powell that the investment involved a high degree of risk; [and] Powell . . . testified that Yates promised him a guaranteed return of eight percent per annum, and that the investment could be cashed in at any time with a small discount.").

[129] *See, e.g.*, *In re* Stewart, No. 97-05-59, 1998 Miss. Sec. LEXIS 3 (Aug. 27,

Business Services Division found that Boston Acceptance Corporation d/b/a First Lenders Indemnity Company (FLIC) and its principals, Boston and Cunningham, made a number of material misrepresentations and omissions in connection with their efforts to solicit Mississippi investors to purchase promissory notes, including, but not limited to: (1) failing to disclose that Boston had been previously convicted of bank fraud; (2) failing to disclose that FLIC was subject to a cease and desist order issued by the state of Missouri for selling the same notes FLIC was selling in Mississippi; (3) failing to disclose that the SEC had secured a permanent injunction against FLIC, Boston, and Cunningham, who also agreed to pay $85,000 in civil penalties for violations of federal securities law; (4) failing to disclose that any sale of the promissory notes would violate the aforementioned injunction; and (5) misrepresenting that the promissory notes were exempt from registration under both Mississippi and federal law.[130]

In *In re J. F. (Jim) Straw d/b/a American Business Club*,[131] the Securities Division found that the offerors made several material misrepresentations in connection with their offer of securities in the form of agreement or contract under which the offeree agreed to pay periodically small amounts of money in order to receive a larger, interest-free loan at some future date to be determined by the offeror, which the offeree was obligated to repay. Specifically, the offerors misrepresented

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1998); *In re* Crites, No. 97-05-50, 1998 Miss. Sec. LEXIS 2 (June 18, 1998); *In re* Dennis, No. 97-05-58, 1998 Miss. Sec. LEXIS 45 (June 18, 1998); *In re* Minga, No. 97-05-49, 1998 Miss. Sec. LEXIS 1 (June 18, 1998).

These and other actions were brought against individual agents for, *inter alia*, selling unregistered securities in Mississippi. None of the enforcement orders against the individual agents finds that any of them made material misrepresentations or omissions.

[130] *In re* Boston Acceptance Corp., No. 97-05-45, 1997 Miss. Sec. LEXIS 7, at *3-4 (Aug. 15, 1997). In addition to these material misrepresentations and omissions, which the Division found to be violations of section 501 of the MSA, MISS. CODE ANN. § 75-71-501 (2000); *see Boston Acceptance*, 1997 Miss. Sec. LEXIS 7, at *8. The Division also found that FLIC, Boston and Cunningham violated section 115 of the MSA, MISS. CODE ANN. § 75-71-115, by filing documents with the Secretary of State's office that contained "misleading statements and material falsehoods," *Boston Acceptance*, 1997 Miss. Sec. LEXIS 7, at *4.

[131] No. 92-04-08, 1992 Miss. Sec. LEXIS 17 (Apr. 17, 1992).

that: (1) the funds from which the offerees' future payments would come were "guaranteed," (2) the interest-free loan was a "grant," (3) the interest-free loan was a "cash giveaway," (4) any payments made by the offerees to the offerors were "100% Deductible" for tax purposes, (5) an offeree could decrease her waiting time before receiving her interest-free loan by increasing her periodic payments to the offerors, and (6) the offerees were at no risk of losing the funds they invested with the offerors.[132]

In *In re BMT Racing Stables*,[133] respondents were soliciting investments in thoroughbred race horses. The Securities Division found that the respondents (BMT) had materially misrepresented their ownership of horses stabled at a Lexington, Kentucky training center (BMT, in fact, did not own any horses stabled there) and their ability to provide videotapes of horses owned by BMT (there were no such tapes).[134] The Securities Division also found that including in the offering materials a photograph of a horse named "Oreo Jack" was misleading because it gave the false impression that "Oreo Jack" was one of the horses in which an investor could purchase an interest when, in fact, BMT was not offering any interests in "Oreo Jack."[135]

The Mississippi Supreme Court has adopted the federal "bespeaks caution" doctrine to hold otherwise material misrepresentations immaterial as a matter of law if they are accompanied by sufficient "cautionary language."[136]

> The "Bespeaks Caution" doctrine applies when "optimistic projections are coupled with cautionary language—in particular, relevant specific facts or assumptions—affecting the reasonableness of the reliance on and the materiality of those projections." This means that offered documents must be read as a whole, and their statements must be read in context.[137]

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[132] *See id.* at *3-4.

[133] No. CD-86-8-1, 1986 Miss. Sec. LEXIS 1 (Sep. 10, 1986).

[134] *BMT Racing Stables*, 1986 Miss. Sec. LEXIS, at *2.

[135] *See id.*

[136] *See* Allyn v. Wortman, 725 So. 2d 94, 103 (Miss. 1998) (citing Moorhead v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 949 F.2d 243, 245-46 (8th Cir. 1991)).

[137] *Allyn*, 725 So. 2d at 103 (quoting Rubinstein v. Collins, 20 F.3d 160, 167

3. No Reliance Required

Unlike common law fraud,[138] negligent misrepresentation,[139] and Rule 10b-5,[140] section 717(a)(2) does not require

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(5th Cir. 1994) (citation omitted)). In *Allyn*, the plaintiffs complained that the defendants misrepresented material facts in soliciting the plaintiffs' investments in a casino project. *Id.* at 97. The court found that the "bespeaks caution" doctrine insulated the defendants from liability:

> [T]he PPM is replete with warnings and cautionary language regarding the casino venture. Furthermore, the PPM was targeted to a specific group of investors. The Investors were not targeted by the Defendants, did not buy the Preferred Stock through the issuance discussed in the PPM, and did not even purchase the same class of stock as described in the PPM. When considering the PPM, as a whole, it is clear that the warnings are sufficient as a matter of law.

Id. at 103. *But see id.* at 105 (McRae, J., dissenting) (arguing that whether "bespeaks caution" doctrine insulates defendant from liability must be determined on case-by-case basis by trier of fact, rather than as matter of law by court).

[138] To recover on a claim of common law fraud, a Mississippi plaintiff must plead and prove:

> (1) a representation; (2) its falsity; (3) its materiality; (4) the speaker's knowledge of its falsity or ignorance of its truth; (5) the speaker's intent that the representation should be acted upon by the hearer and in the manner reasonably contemplated; (6) the hearer's ignorance of its falsity; (7) the hearer's reliance on the representation's truth; (8) the hearer's right to rely thereon; and (9) the hearer's consequent and proximate injury.

Levens v. Campbell, 733 So. 2d 753, 761-62 (Miss. 1999); *see* Allen v. Mac Tools, Inc., 671 So. 2d 636, 642 (Miss. 1996); Franklin v. Lovitt Equip. Co., 420 So. 2d 1370, 1373 (Miss. 1982).

Absent justifiable reliance, a plaintiff's fraud claim will fail. *See, e.g.*, *Franklin*, 420 So. 2d at 1373. That said, reliance does not require that the material misrepresentation or omission "be the predominating inducement to act. If the statement was false, was a material factor inducing a third person to act in reliance to his detriment, and if reliance by the third person was reasonably foreseeable to the speaker or author of the statement, then the speaker or author is liable for damage proximately caused thereby." Felts v. Nat'l Account Sys. Ass'n, 469 F. Supp. 54, 67 (N.D. Miss. 1978) (citing H. D. Sojourner & Co. v. Joseph, 191 So. 418, 421-22 (Miss. 1939)).

In *Geisenberger v. John Hancock Distributors, Inc.*, 774 F. Supp. 1045 (S.D. Miss. 1991), the court found that the plaintiff justifiably relied on the defendants' representations, notwithstanding contrary information in the prospectus, "because of the difficulty that a relatively unsophisticated investor would have in comprehending the nature of an investment about which even [the defendant] stockbroker is confused." *Geisenberger*, 774 F. Supp. at 1052.

[139] To recover on a claim of negligent misrepresentation, a Mississippi plaintiff

that the buyer prove reliance on the seller's misrepresentation or omission.[141] That is to say, section 717(a)(2) does not re-

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must plead and prove:

> (1) a misrepresentation or omission of a fact; (2) that the representation [or omission] is material or significant; (3) failure to exercise reasonable care on the part of the defendant; (4) reasonable reliance on the misrepresentation or omission; and (5) damages as a direct result of such reasonable reliance.

Levens, 733 So. 2d at 762. Absent justifiable reliance, a plaintiff's negligent misrepresentation claim will fail. *See, e.g.*, Arnona v. Smith, 749 So. 2d 63, 67 (Miss. 1999).

[140] The elements of a cause of action under section 10(b) of the 1934 Act and Rule 10b-5 are: (1) a misrepresentation or omission (2) of a material fact, (3) made knowingly or without knowledge of the truth thereof (4) by a person who owes the plaintiff a duty to disclose, (5) on which the plaintiff relied, (6) resulting in damage to the plaintiff. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449-50 (1976); Paracor Fin., Inc. v. Gen. Elec. Capital Corp., 96 F.3d 1151, 1157 (9th Cir. 1996). However, where a plaintiff alleges a fraudulent omission, "positive proof of reliance is not a prerequisite to recovery." Affiliated Ute Citizens v. United States, 406 U.S. 128, 153-54 (1972); *accord* Burke v. Jacoby, 981 F.2d 1372, 1379 (2d Cir. 1992). "All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision." *Affiliated Ute Citizens*, 406 U.S. at 153-54.

For a detailed discussion of the elements of and principal defenses to liability under section 10(b) of the 1934 Securities Exchange Act and Rule 10b-5 promulgated thereunder, which is the principal avenue available to private litigants under federal securities law, see Keith A. Rowley, *Cause of Action for Securities Fraud Under Section 10(b) of the 1934 Securities Exchange Act and/or Rule 10b-5*, *in* 9 CAUSES OF ACTION 2D 271 (1997).

[141] *See* MISS. CODE ANN. § 75-71-717(a)(2) (2000); *supra* text accompanying note 110. *But see Geisenberger*, 774 F. Supp. at 1051 (finding that section 717(a)(2) "contain[s] an implicit requirement of reasonable reliance consistent with federal Rule 10b-5"), *declined to follow on other grounds by Allyn*, 725 So. 2d at 94. While *Allyn* only specifically disagreed with *Geisenberger*'s conclusion that section 501 of the MSA gives rise to an implied private right of action, compare *Geisenberger*, 774 F. Supp. at 1049 with *Allyn*, 725 So. 2d at 102. *Geisenberger* appears to make a number of errors in its assessment of the MSA, owing to the district judge's dogged attempt to analogize section 717(a)(2) to Rule 10b-5, rather than to section 12(a)(2), with which section 717(a)(2) has much more in common. *See supra* note 110. Consequently, the *Geisenberger* court erroneously imported the Rule 10b-5 "loss causation" element into his section 717(a)(2) analysis. *See Geisenberger*, 774 F. Supp. at 1051. Fortunately, while Judge Barbour appears to have been doctrinally wrong in implying reliance and loss causation elements into a section 717(a)(2) claim, he found sufficient facts in the case at bar to satisfy both putative elements. *See id.* As a net result, his holding was the same as it should have been absent the two misplaced elements.

A plaintiff suing under section 12(a)(2) of the 1933 Act need not prove reli-

quire that the plaintiff show that she would not have purchased the stock if she had known of the alleged adverse material facts.

4. No Scienter Required

Nor does the section 717(a)(2) require the buyer to prove that the seller knew the representation was false or made it without regard to its truth or falsity with the intent that the buyer rely upon it[142]—as is required to show common law

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ance. A section 12(a)(2) plaintiff is only required to prove (1) an offer or sale of a security, (2) by the use of any means of interstate commerce, (3) through a prospectus or oral communication (4) which includes an untrue statement of material fact or omits to state a material fact, (5) that plaintiff did not know to be false. *See* 15 U.S.C. § 77*l*(a)(2) (Supp. V 1999); Cook v. Avien, Inc., 573 F.2d 685, 693 (1st Cir. 1978); Gridley v. Sayre & Fisher Co., 409 F. Supp. 1266, 1272-73 (D.S.D. 1976); Thiele v. Shields, 131 F. Supp. 416, 419 (S.D.N.Y. 1955). Reliance is not an element of a section 12(a)(2) claim. *See* Metromedia Co. v. Fugazy, 983 F.2d 350, 361 (2d Cir. 1992); Sanders v. John Nuveen & Co., 619 F.2d 1222, 1225 (7th Cir. 1980). Indeed, some courts have gone so far as to hold that a section 12(a)(2) plaintiff need not have *read* the allegedly misleading prospectus prior to purchasing the securities in question. *See* Caviness v. DeRand Res. Corp., 983 F.2d 1295, 1305 (4th Cir. 1993). Indeed, some courts have held that a section 12(a)(2) plaintiff need not have *received* the prospectus prior to purchase. *See In re* TCW/DW N. Am. Gov't Income Trust Sec. Litig., 941 F. Supp. 326, 337 (S.D.N.Y. 1996); Klein v. Computer Devices, Inc., 591 F. Supp. 270, 277 (S.D.N.Y. 1984).

For a detailed discussion of the elements of and principal defenses to liability under section 12(a)(2), see Keith A. Rowley, *Cause of Action for Securities Fraud Under Section 12(2) of the 1933 Securities Act*, *in* 11 CAUSES OF ACTION 2D 1 (1998).

[142] *See supra* note 110; *see e.g.*, Fortenberry v. Foxworth Corp., 825 F. Supp. 1265, 1279 (S.D. Miss. 1993).

fraud[143] or a Rule 10b-5 violation.[144] Rather, as is the case with section 12(a)(2),[145] the seller's lack of scienter is an affirmative defense to a section 717(a)(2) claim.[146]

5. *No "Duty" Required*

Furthermore, section 717(a)(2) does not require that the seller owe the purchaser any duty to disclose in order for an omission of material fact to be actionable, but rather implies such a duty in every securities offering or sale.[147]

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[143] *See supra* note 138; *see, e.g.*, Russell v. S. Nat'l Foods, Inc., 754 So. 2d 1246, 1256 (Miss. 2000) (requiring "an affirmative intent to deceive").

In order to establish the requisite intent to deceive, a plaintiff must establish that the defendant made a statement (1) with actual knowledge of its falsity; (2) recklessly without knowledge or disregard of either truth or falsity; or (3) under circumstances which indicate that the speaker should have known it was false, irrespective of whether or not he actually knew it was false. Felts v. Nat'l Account Sys. Ass'n, 469 F. Supp. 54, 67 (N.D. Miss. 1978) (citing H. D. Sojourner & Co. v. Joseph, 191 So. 418, 421 (Miss. 1939)).

Common law negligent misrepresentation does not require proof of scienter because, if scienter were present, the defendant's actions would be fraudulent, not negligent.

[144] *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976); *supra* note 140.

[145] *See supra* note 141.

[146] *See infra* Part II.C.6.c.ii.

[147] By contrast,

> Rule 10b-5 is violated by nondisclosure only when there is a duty to disclose. The parties to an impersonal market transaction owe no duty of disclosure to one another absent a fiduciary or agency relationship, prior dealings, or circumstances such that one party has placed trust and confidence in the other. A number of factors are used to determine whether a party has a duty to disclose: (1) the relationship of the parties, (2) their relative access to information, (3) the benefit that the defendant derives from the relationship, (4) the defendant's awareness that the plaintiff was relying upon the relationship in making his investment decision, and (5) the defendant's activity in initiating the transaction.

Paracor Fin., Inc. v. Gen. Elec. Capital Corp., 96 F.3d 1151, 1157 (9th Cir. 1996) (quotations and citations omitted).

6. *Defenses to Primary Securities Fraud Liability*[148]

a. Standing

Section 717(a)(2)'s protection, like that of section 717(a)(1)[149] and section 12(a)(2),[150] extends only to buyers. Persons who did not buy the security thus lack standing to sue the person who sold it.[151]

b. Limitations

A plaintiff must bring a section 717(a)(2) claim within two years of the date on which the plaintiff knew, or should have known through the exercise of reasonable diligence, of the existence of her claim.[152] The question of when a plaintiff dis-

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[148] In addition to the statutory defenses discussed here, one or more common law affirmative defenses might be available to a section 717(a)(2) defendant. *See generally* Charles G. Stinner, Note, *Estoppel and* In Pari Delicto *Defenses to Civil Blue Sky Law Actions*, 73 CORNELL L. REV. 448 (1988) (discussing viability of estoppel and *in pari delicto* defenses under state blue sky laws).

[149] *See supra* Part II.B.4.a.

[150] *See, e.g.*, Ratner v. Sioux Natural Gas Corp., 770 F.2d 512, 517 (5th Cir. 1985) (holding that non-purchasers lack standing to sue under section 12(a)(2)).

[151] *See supra* note 102.

By contrast, sellers can sue both under section 10(b) and/or Rule 10b-5, *see, e.g.*, Fortenberry v. Foxworth Corp., 825 F. Supp. 1265, 1279 (S.D. Miss. 1993); *see also, e.g.*, Am. Gen. Ins. Co. v. Equitable Gen. Corp., 493 F. Supp. 721, 744-47 (E.D. Va. 1980); Rude v. Cambell Square, Inc., 411 F. Supp. 1040, 1049-50 (D.S.D. 1976), and at common law, *see, e.g.*, *Fortenberry*, 825 F. Supp. at 1279.

[152] MISS. CODE ANN. §§ 75-71-725 (2000); *see, e.g.,* Holland v. Mayfield, No. 96-CA-01169-SCT, 1999 WL 353023, at *9 (Miss. June 3, 1999).

By comparison, claims under section 12(a)(2) of the 1933 Securities Act, section 10(b) of the 1934 Securities Exchange Act, or Rule 10b-5 must be brought no more than three years after the cause of action accrued, but in any case within one year of the date on which plaintiff discovered, or in the exercise of reasonable diligence should have discovered, the existence of her claim. *See* 15 U.S.C. § 77m (Supp. V 1999) (limitations for section 12(a)(2) claim); Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson, 501 U.S. 350, 364 (1991) (limitations for section 10(b) or Rule 10b-5 claim).

The statute of limitations for common law fraud claims runs for three years from the date the plaintiff's cause of action accrued. *See* MISS. CODE ANN. § 15-1-49(1) (1995 & Supp. 2000); *see, e.g.*, *Holland*, 1999 WL 35023, at *8. Claims of negligent misrepresentation are also subject to a three-year limitations period. *See* MISS. CODE ANN. § 15-1-49(1); *see, e.g.*, Air Comfort Sys., Inc. v. Honeywell, Inc., 760 So. 2d 43, 47 (Miss. Ct. App. 2000). Limitations for fraud and negligent mis-

covered or, through reasonably diligent inquiry should have discovered, facts sufficient to trigger the two-year limitations period is generally a question of fact.[153]

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representation, unlike limitations under section 725, do not appear to be tolled until the plaintiff discovers, or through the exercise of reasonable diligence should have discovered, her injury. *See* MISS. CODE ANN. § 15-1-49(2) (tolling limitations until discovery only in cases involving latent injury and disease). However,

> [i]f a person liable [for fraud or negligent misrepresentation] shall fraudulently conceal the cause of action from the knowledge of the person entitled thereto, the cause of action shall be deemed to have first accrued at, and not before, the time at which such fraud shall be, or with reasonable diligence might have been, first known or discovered [by the plaintiff].

Id. § 15-1-67; *see, e.g.*, Smith v. Franklin Custodian Funds, Inc., 726 So. 2d 144, 147 (Miss. 1998). Fraudulent concealment will toll limitations against a defendant as long as the fraud was committed by the defendant or someone in privity with the defendant. *See Smith*, 726 So. 2d at 147.

[153] *See, e.g.*, Stewart v. Germany, 631 F. Supp. 236, 247-48 (S.D. Miss. 1986) (applying section 725).

In *Holland*, the Mississippi Supreme Court found that the plaintiffs timely filed their complaint on April 10, 1993, despite the defendant's argument that one or more plaintiff(s) knew or should have known of the alleged fraud more than two years before filing suit. *Holland*, 1999 WL 35023, at *8.

> Holland contends that the Investors are barred because one of the Investors, Ward, testified that he had suspicions that there had been front-end profits paid as early as February of 1990 when he went to Houston to try and audit the books of BT. At that time, he discovered that a check for $32,000 had been written to a Laurel law firm. Holland also points to the testimony of another Investor, Ferguson, who testified that he may have known about Holland getting a front-end profit in 1990.
>
> The record in this case contradicts Holland's assertions as to when the Investors discovered that Holland had received a front-end profit on the Chandeleur Prospect. First, in his testimony concerning the $32,000 check, Ward did not state that he knew that the check was paid on behalf of Holland. Ward went on to testify that he asked Holland the day of the discovery of the check if Holland knew of any reason that that check would have been paid to a Laurel law firm, and Holland responded that he did not.
>
> Further, a reading of Ferguson's testimony shows that he was unsure of when or from whom he received the information that Holland had received a front-end commission. It was only when he was pressed by Holland's attorney to give a specific year, that Ferguson reluctantly said, "1990." He then qualified his statement by testifying that, "a lot of things escape me now, and please understand that this is true. I just can't remember a lot of things after my open heart surgery."
>
> The other Investors testified that they first discovered that front-end commissions had been paid to Holland, the Evanses, and Gaskin, from a

In *Seaboard Planning Corp. v. Powell*,[154] decided under the precursor to section 725,[155] the defendants argued that limitations began to run when the plaintiffs (the Powells) received the prospectus, a careful reading of which might have disclosed the misrepresentations made previously by defendant Yates.[156] The Powells argued that limitations did not begin to run until ten months later, when they did not receive the dividend check they had been promised.[157] The trial court and the Mississippi Supreme Court agreed with the Powells:

> To start the running of [limitations], there must be not only fraud but some event to put the Powells on notice. Here the Powells' lack of education was a factor in the success of the fraud. At the time the fraud was perpetrated upon the uneducated Powells, it cannot logically be held that they as reasonable persons should have known of the fraud from the very instant they fell for Yates' misrepresentations. The first indication that things were not as Yates had made them out to be was the receipt in October of $200 for the third quarter of 1974, which would place the filing of suit well within the statute. We think the evidence establishes that Yates knew or should have known that even if the Powells undertook to peruse the prospectus they would not be able to comprehend its contents. The very nature of fraud is such that it cannot be discovered until sometime after the fraudulent act is committed. Here, the Powells had no reason to suspect Yates or distrust his representations until such time as they were put on notice by the smaller payments or the absence of payments. On these facts, we hold that the statute did not begin to run until the Powells received the check for the third quar-

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deposition taken from one of the BT principals in the Texas case on January 2, 1992. The Investors' Complaint was filed on April 10, 1993, well within the statute of limitation.

Id.

[154] 364 So. 2d 1091 (Miss. 1978).

[155] Former section 75-71-31 of the Mississippi Code afforded a plaintiff two years within which to sue after she, "by the exercise of ordinary care, should have discovered that such sale was made . . . upon misrepresentation." MISS. CODE ANN. § 75-71-31 (1972), *repealed by* 1981 Miss. Laws, ch. 521, § 418.

[156] *See Powell*, 364 So. 2d at 1094.

[157] *See id.*

ter of 1974. Accordingly, the suit, filed less than two years afterward, was not barred by the statute.[158]

c. *Other Statutory Defenses*

Unlike a section 717(a)(1) defendant, whose only statutory defenses are standing[159] and limitations,[160] section 717(a)(2) defendants have two additional statutory defenses.

i. *Plaintiff's Actual Knowledge*

First, a defendant is not liable under section 717(a)(2) if he can prove that the plaintiff actually knew of the untruth or omission.[161] The burden is on the defendant to prove the

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[158] *Id.* at 1094-95.

[159] *See supra* Part II.B.3.a.

[160] *See supra* Part II.B.3.b.

[161] *See* MISS. CODE ANN. § 75-71-717(a)(2) (2000) ("Any person who . . . offers or sells a security by the use of . . . any untrue statement of a material fact or any omission to state a material fact . . . (the buyer not knowing of the untruth or omission) . . . is liable to the person buying the security from him . . . .").

A section 12(a)(2) plaintiff who actually knows of the defendant's alleged fraud may be precluded from recovering damages allegedly caused by that fraud. *See* 15 U.S.C. § 77*l*(a)(2) (Supp. V 1999); Haralson v. E.F. Hutton Group, Inc., 919 F.2d 1014, 1032 (5th Cir. 1990); Mayer v. Oil Field Sys. Corp., 803 F.2d 749, 755 (2d Cir. 1986); *accord* Wright v. Nat'l Warranty Co., 953 F.2d 256, 262 (6th Cir. 1992); *In re* TCW/DW N. Am. Gov't Income Trust Sec. Litig., 941 F. Supp. 326, 337 (S.D.N.Y. 1996). The burden of pleading and proving her lack of actual knowledge rests on the section 12(a)(2) plaintiff. *See, e.g.*, Junker v. Crory, 650 F.2d 1349, 1359 (5th Cir. 1981); Gilbert v. Nixon, 429 F.2d 348, 356 (10th Cir. 1970); *In re* Gap Stores Sec. Litig., 79 F.R.D. 283, 306 (N.D. Cal. 1978). It is less clear whether the plaintiff's actual knowledge of the defendant's fraud precludes her from recovering under section 10(b) and Rule 10b-5. *Compare, e.g.*, Ray v. Karris, 780 F.2d 636, 643 (7th Cir. 1985) (holding that plaintiffs were unable to maintain derivative action under Rule 10b-5 where they knew "at least the essential facts" of defendants' fraudulent scheme before scheme was consummated), Cent. Microfilm Serv. Corp. v. Basic/Four Corp., 688 F.2d 1206, 1219 (8th Cir. 1982) (arguing simple logic dictates that actual knowledge of fact allegedly omitted defeats fraud claim based upon that omission, *and* Horowitz v. Pownall, 105 F.R.D. 615, 621 (D. Md. 1985) (quoting *Central Microfilm* with approval), *aff'd sub nom.* Zimmerman v. Bell, 800 F.2d 386 (4th Cir. 1986), *with*, Travis v. Anthes Imperial Ltd., 473 F.2d 515, 521-23 (8th Cir. 1973) (finding that fact that sale of securities took place when plaintiffs were aware of all facts, including defendants' misrepresentations, was not fatal to plaintiffs' section 10(b) claim where defendants' misrepresentations allegedly induced plaintiffs to retain their stock

plaintiff's actual knowledge, rather than on the plaintiff to prove his lack of knowledge or his diligence in seeking to determine the truthfulness of the defendant's misrepresentation or omission. The MSA imposes no duty of inquiry on the plaintiff.[162]

ii. Defendant's Lack of Knowledge

Second, section 717(a)(2) excuses a defendant from liability for a material misrepresentation or omission if the defendant

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until, by reason of de facto merger, defendants controlled relevant market and could dictate price of their stock); Kohn v. Am. Metal Climax, Inc., 458 F.2d 255, 269 (3d Cir. 1972) ("[I]t is [not] a defense to a finding of material violations of 10b-5 to say that some stockholders 'discovered' the misrepresentations . . . and thus were not misled . . . ."); Stewart v. Bennett, 359 F. Supp. 878, 881 n.9 (D. Mass. 1973) (stating that section 10(b) affords no defense on ground of either plaintiffs' knowledge), *supplemented on other grounds*, 362 F. Supp. 605 (D. Mass. 1973).

The plaintiff's ignorance of the falsity of the defendant's misrepresentation is an element of common law fraud. *See supra* note 138. Because it is an element of the claim, the plaintiff bears the burden of pleading and proving her lack of knowledge.

[162] Similarly, section 12(a)(2) imposes no duty of inquiry on the plaintiff. *See Wright*, 953 F.2d at 262.

> Indeed, a purchaser who is actually ignorant that a seller's representation is inaccurate or incomplete may recover even though the full truth is apparent from materials in her possession. The concept of a plaintiff's constructive knowledge has no place in section 12(2) actions.

Haralson, 919 F.2d at 1032 n.10 (citation omitted).

Authorities are split on the availability of a due diligence defense to liability under section 10(b) and Rule 10b-5. *Compare, e.g.*, Warren v. Reserve Fund, Inc., 728 F.2d 741, 747 (5th Cir. 1984); Edwards & Hanly v. Wells Fargo Sec. Clearance Corp., 602 F.2d 478, 485-86 (2d Cir. 1979), Straub v. Vaisman & Co., 540 F.2d 591, 597-98 (3d Cir. 1976), Weir v. Merrill Lynch Pierce Fenner & Smith, Inc., 586 F. Supp. 63, 65 (S.D. Fla. 1984) (all recognizing some form of "due diligence" defense), *with,* Sundstrand Corp. v. Sun Chem. Corp., 553 F.2d 1033, 1048 (7th Cir. 1977); Holdsworth v. Strong, 545 F.2d 687, 694 (10th Cir. 1976) (both holding that plaintiff's diligence is irrelevant and/or that there is no "due diligence" defense). Once the defendant raises the plaintiff's diligence as a defense to section 10(b)/Rule 10b-5 liability, the plaintiff bears the burden of negating her own recklessness. *See, e.g.*, Royal Am. Managers, Inc. v. IRC Holding Corp., 885 F.2d 1011, 1015-16 (2d Cir. 1989). Mere negligence on the plaintiff's part will not defeat the defendant's liability. *See* Citizens & S. Sec. Corp. v. Braden, 733 F. Supp. 655, 666 (S.D.N.Y. 1990). In order to defeat a due diligence defense, the plaintiff need only prove that she acted "reasonably" in the underlying transaction. *See Straub*, 540 F.2d at 598.

can show that he did not, and could not by the exercise of reasonable care, know of the untruth or omission.[163] The burden is on the defendant to prove his own reasonable diligence and lack of actual knowledge, rather than on the plaintiff to prove the defendant's actual knowledge or lack of diligence.

D. Statutory Secondary Liability

The MSA's reach is not limited to only those persons who actually sold unregistered securities or who offered or sold securities by means of a material misrepresentation or omission. Section 719 holds certain indirect sellers jointly and severally liable for a direct seller's violation of section 717.[164]

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[163] *See* MISS. CODE ANN. § 75-71-717(a)(2) ("Any person who . . . offers or sells a security by the use of . . . any untrue statement of a material fact or any omission to state a material fact . . . , and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable to the person buying the security from him . . . .").

Section 12(a)(2) excuses from liability any defendant who "sustain[s] the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission." 15 U.S.C. § 77*l*(a)(2); *see, e.g.*, Ambrosino v. Rodman & Renshaw, Inc., 972 F.2d 776, 787-88 (7th Cir. 1992); Alton Box Bd. Co. v. Goldman, Sachs & Co., 560 F.2d 916, 918 (8th Cir. 1977). A section 10(b)/Rule 10b-5 defendant can avoid liability by proving, by a preponderance of the evidence, that any misrepresentation or omission he made was not made knowingly, intentionally, with the intent to defraud or with reckless disregard for its truth or falsity. *See, e.g.*, *In re* Worlds of Wonder Sec. Litig., 814 F. Supp. 850, 870 (N.D. Cal. 1993), *aff'd in part, rev'd in part on other grounds*, 35 F.3d 1407 (9th Cir. 1994); Koehler v. Pulvers, 614 F. Supp. 829, 848 (S.D. Cal. 1985); Pachter v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 444 F. Supp. 417, 422 (E.D.N.Y.), *aff'd*, 594 F.2d 852 (2d Cir. 1978).

[164] MISS. CODE ANN. § 75-71-719.

> Every person who directly or indirectly controls a seller liable under section 75-71-717, every partner, officer or director of such a seller, every person occupying a similar status or performing similar functions, every employee of such a seller who materially aids in the sale, and every broker-dealer who materially aids in the sale [is] also liable jointly and severally with and to the same extent as the seller . . . .

Id. For purposes of the MSA, "officer" means

> a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any other persons performing similar functions with respect to any organization whether incorporated or unincorporated. A person shall not be deemed an officer merely because he is titled as such if he does not perform the legal func-

A purchaser seeking to establish secondary liability for a registration violation under section 719 need not prove that the indirect seller knew that the law required the security to be registered. The indirect seller's lack of knowledge is an affirmative defense that she must plead and prove.[165] A person who sells securities in concert with another person may be liable both as a primary violator and as a collateral participant.[166]

As a general rule, a plaintiff may sue a jointly and severally liable collateral participant without also suing the jointly and severally liable primary violator.[167]

1. Liability for "Controlling" a Primary Violator

Section 719 holds "[e]very person who directly or indirectly controls a seller liable under [s]ection 75-71-717, every partner, officer or director of such a seller, [and] every person occupying a similar status or performing similar functions . . . jointly and

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tion of an officer.

Rule 103(L), Miss. Blue Sky Regs., *reprinted in* 2A BLUE SKY L. REP. (CCH) ¶ 34,403, at 29,402-03 (1998).

[165] *See supra* Part II.B.3.d.

[166] *See, e.g.*, First Mobile Home Corp. v. Little, 298 So. 2d 676, 681 (Miss. 1974).

[167] *See generally* Hall v. Hilbun, 466 So. 2d 856, 879 (Miss. 1985) ("[J]oint tortfeasors are jointly and severally liable to the plaintiff who, at his election, may sue fewer than all and recover full damages from those sued."). The same is true under analogous federal law. *See, e.g.*, SEC v. Savoy Indus., Inc., 587 F.2d 1149, 1170 n.47 (D.C. Cir. 1978) (reciting that, in action against control person, "the plaintiff need not proceed against the principal perpetrator, nor need the principal perpetrator be identified in the complaint"); Kemmerer v. Weaver, 445 F.2d 76, 78-79 (7th Cir. 1971) (holding that action against controlling persons may continue despite dismissal of suit against primary violator); Keys v. Wolfe, 540 F. Supp. 1054, 1062 (N.D. Tex. 1982) ("Nothing in the language of section 20(a) compels the presence of the controlled person whose misdeeds are sought to be attributed to the defendants charged to be controlling persons, and nothing in familiar and conceptually related attribution principles such as conspiracy membership, agency, or aider and abettor, demands a visiting of actual liability upon an active wrongdoer as a condition to an attribution of that liability."), *rev'd on other grounds*, 709 F.2d 413 (5th Cir. 1983); *see also* Ernest L. Folk, III, *Civil Liabilities Under the Federal Securities Acts: The* BarChris *Case (Part II)*, 55 VA. L. REV. 199, 217-18 (1969) (analogizing control person liability under 1933 Act to common law of master and servant and pointing out that, at common law, "[a] master answers vicariously for a servant's wrong, not for his adjudicated liability").

severally [liable] with and to the same extent as the seller."[168] "Control," in turn, means "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."[169] The power to control, whether or not the power is exercised, is the key.

The MSA's control person liability provisions parallel both section 15 of the 1933 Securities Act[170] and section 20(a) of the 1934 Securities Exchange Act,[171] and may be interpreted

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[168] MISS. CODE ANN. § 75-71-719; *see, e.g.,* Felts v. Nat'l Account Sys. Ass'n, 469 F. Supp. 54, 67-68 (N.D. Miss. 1978) (applying former Mississippi Securities Law, MISS. CODE ANN. § 75-71-1 *et seq.* (1972), *repealed by* 1981 Miss. Laws, ch. 521, § 418, to hold issuing corporation's past and current presidents, its vice-president and its treasurer liable as control person).

[169] Rule 103(F), Miss. Blue Sky Regs., reprinted in 2A BLUE SKY L. REP. (CCH) ¶ 34,403, at 29,401 (1998).

Rule 103(F) is an almost verbatim copy of SEC Rule 405(f). *See* 17 C.F.R. § 230.405 (2000) (defining "control" for purposes of federal securities law). For an excellent discussion of control person liability under federal securities law, discussing, *inter alia*, the likely outcome of a control-person analysis under a number of sample fact patterns, see Loftus C. Carson, II, *The Liability of Controlling Persons Under the Federal Securities Acts*, 72 NOTRE DAME L. REV. 263 (1997).

[170] Section 15 provides:

> Every person who, by or through stock ownership, agency, or otherwise, . . . controls any person liable under section . . . 77*l* of this title, shall also be liable jointly and severally with and to the same extent as such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77o (1994).

[171] Section 20(a) provides:

> Every person who, directly or indirectly, controls any person liable under any provision of this chapter or any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

Id. § 78t(a). Section 15 of the 1933 Act and section 20(a) of the 1934 Act, despite somewhat different wording, are analogous provisions that should be interpreted similarly. *See, e.g.*, Pharo v. Smith, 621 F.2d 656, 673-74 (5th Cir.), *modified on other grounds*, 625 F.2d 1226 (5th Cir. 1980); *Felts*, 469 F. Supp. at 66.

In the wake of the Private Securities Litigation Reform Act, *see supra* note 2, joint and several liability for control persons under federal law may now be avail-

and applied accordingly.

The plaintiff bears the burden of establishing control. As a general rule, a plaintiff should plead and prove that the defendant (1) exercised active control over the day-to-day affairs of the controlled person or entity and (2) had the power to control and influence the particular transactions that gave rise to the underlying securities violations.[172]

The MSA does not require the plaintiff to prove that the control person acted with knowledge of the underlying violation or with reckless disregard for the truthfulness of the primary violator's acts or omissions;[173] rather, the control person's lack of scienter is an affirmative defense to a section 719 claim.[174] If the plaintiff can prove that the controlled person violated section 717 and that the defendant was a "control person" under the statute, then judgment against the control person will be proper in the absence of a viable affirmative defense.[175]

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able only if the control person "knowingly committed a violation of the securities laws." *Compare* 15 U.S.C. § 78u-4(f)(2)(A) (Supp. V 1999), *with id.* §§ 77o, 78t(a). In the absence of a knowing violation, federal law may afford a plaintiff only proportionate liability against a control person. *See* Marc I. Steinberg & Christopher D. Olive, *Contribution and Proportionate Liability Under the Federal Securities Laws in Multidefendant Securities Litigation After the Private Securities Litigation Reform Act of 1995*, 50 SMU L. REV. 337, 349-50 (1996); Glen Shu, Comment, *Take a Second Look:* Central Bank *After the Private Securities Litigation Reform Act of 1995*, 33 HOUS. L. REV. 539, 569 (1996). If this proves to be the case, the MSA could now afford a Mississippi plaintiff greater relief than its federal progenitors.

[172] *See, e.g.*, Abbott v. Equity Group, Inc., 2 F.3d 613, 620 (5th Cir. 1993); Metge v. Baehler, 762 F.2d 621, 631 (8th Cir. 1985). Thus, for example, in *G.A. Thompson & Co. v. Partridge*, 636 F.2d 945 (5th Cir. 1981), the Fifth Circuit found that a twenty-four percent (24%) shareholder, who was also an officer and director, and was involved in the day-to-day supervision of the types of activities that gave rise to the plaintiff's claims, was a "control person" under section 20 of the 1934 Act, 15 U.S.C. § 78t(a). *See G.A. Thompson & Co.*, 636 F.2d at 958. However, the court went on to note that "effective day-to-day control" may not be required. *See id.* at 958 n.24.

[173] *See* MISS. CODE ANN. § 75-71-719.

[174] *See infra* Part II.D.3.c.

[175] Under the prior Mississippi Securities Act, MISS. CODE ANN. § 75-71-1 *et seq.* (1972), *repealed by* 1981 Miss. Laws ch. 521, § 418, officers and directors were liable only if they participated in or induced the sale of an unregistered security or if they participated in the material misrepresentation or omission that induced the plaintiff to purchase the security. *See, e.g.*, First Mobile Home Corp. v. Little, 298 So. 2d 676, 680 (Miss. 1974). *See generally* Hodge, *supra* note 1, at

2. Liability for "Materially Aiding" a Primary Violator

Section 719 also provides that every employee of a seller liable under section 75-71-717 of the Mississippi Code, as well as every broker-dealer or agent, who "materially aid[ed] in the sale" giving rise to the seller's liability, is "liable jointly and severally with and to the same extent as the seller."[176] A party materially aids a primary violator by, for example, preparing a document containing a material misrepresentation or omission.[177]

The plaintiffs in *Felts v. National Account Systems Ass'n*[178] sued, *inter alia*, Peters, who was the attorney for the issuer (NASA), arguing that he was liable, in addition to those defendants who more directly dealt with the plaintiffs, due to his role in facilitating NASA's violations of state and federal securities law. The court held that

> Peters owed a special duty of diligent investigation and disclosure. Not only was he the lawyer responsible for the issuer's compliance with applicable laws, he also permitted his name (and his office) to be exploited as "president" of NASA when he clearly knew the daily operation of NASA would be controlled by Steen. He permitted NASA to utilize his signature stamp and made no effort to determine how his signature was being used.
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> Peters and Steen jointly decided not to file a registration statement when a reasonable inquiry by Peters clearly would have revealed that no exemption was available for the sale of

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622. As such, the prior law made no effective distinction between "control persons" and "material aiders" as does the current version of the MSA.

[176] MISS. CODE ANN. § 75-71-719 (2000); *see, e.g.*, Felts v. Nat'l Account Sys. Ass'n, 469 F. Supp. 54, 67 (N.D. Miss. 1978) (holding several secondary violators liable as "participants, aiders and abettors and co-conspirators").

[177] *See, e.g.*, *Felts*, 469 F. Supp. at 68. That said, merely "[t]yping, reproducing, [or] delivering sales documents," while those acts "may all be essential to a sale," should not give rise to liability for materially aiding a securities violation, because such acts "could be performed by anyone." Prince v. Brydon, 764 P.2d 1370, 1371 (Or. 1988) (construing similar provision of Oregon Securities Law, OR. REV. STAT. § 59.115(3) (1999)). "[I]t is a drafter's knowledge, judgment, and assertions reflected in the contents of the documents that are 'material' to the sale." *Id.*

[178] 469 F. Supp. 54 (N.D. Miss. 1978).

> these securities. Peters failed to even attempt to determine the registration requirements of Mississippi law and, as a result, NASA initiated the sale of these securities in violation of law.
>
> Peters, as lawyer for the issuer, secured an exemption based on promotional material furnished to him by Steen. He did not make a reasonable inquiry to ascertain the truth or falsity of the representations when these statements could have been readily verified by a lawyer. He secured the certificate of exemption without which these securities would not have been offered or sold when he knew or should have known that NASA was in violation of law, had issued no stock and had no paid-in capital. During the term of the offering, when Peters had ample opportunity to detect the misrepresentations, he failed to report violations to NASA, to the Secretary of State or to the Securities & Exchange Commission.
>
> . . . [W]ithout the active, affirmative assistance of Peters as lawyer for the issuer, including the use and exploitation of his name, the sale would not have been accomplished. Therefore, under applicable law, Peters . . . is jointly liable with the issuer for all damages.[179]

Neither the 1933 Act nor the 1934 Act contains a similar provision. As a consequence, the U.S. Supreme Court has held that no private cause of action exists for aiding and abetting a violation of section 10(b) and Rule 10b-5.[180] The Fifth Circuit

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[179] *Id.* at 68.

[180] *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994). *See generally* Steven A. Meetre, *Textualist Statutory Interpretation Kills Section 10(b) "Aiding and Abetting" Liability*, 63 DEF. COUNS. J. 58 (1996); Marc I. Steinberg, *The Ramifications of Recent U.S. Supreme Court Decisions on Federal and State Securities Regulation*, 70 NOTRE DAME L. REV. 489, 491-501 (1995) (chronicling Supreme Court's adherence to "strict statutory construction" in section 10(b) and Rule 10b-5 cases beginning, prominently, with *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), and culminating in *Central Bank of Denver*).

For many years prior to *Central Bank of Denver*, "suits against aiders and abettors of violations under the federal securities laws had been the most widely used theory to hold nonprivity parties responsible for such violations." Lewis D. Lowenfels & Alan R. Bromberg, *A New Standard for Aiders and Abettors Under the Private Securities Litigation Reform Act of 1995*, 52 BUS. LAW. 1, 1 (1996). Indeed, "all 11 federal courts of appeals that had considered the question had

has followed suit.[181] While it is true that Mississippi courts look to federal decisions for guidance on securities matters,[182] because the *Central Bank of Denver* Court specifically found that no private aiding and abetting cause of action existed because the 1934 Act contained no language providing one,[183] and because the MSA does contain such language, a Mississippi court is not bound by *Central Bank*.

3. Defenses to Statutory Secondary Liability

Collateral participants have the same basic array of statutory defenses at their disposal as do primary violators, although the exact contours of the defenses may not be the same.

a. Standing

Only buyers can sue indirect sellers under section 719.[184]

b. Limitations

As a general rule, claims against collateral participants in a section 717(a)(2) violation must be brought within two years of the date on which the plaintiff knew, or should have known through the exercise of reasonable diligence, of the existence of her claim.[185]

c. Defendant's Lack of Knowledge

Section 719 provides a statutory defense for a secondary violator who pleads and proves that she did not know, and in the exercise of reasonable care could not have known, of the

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already determined that aiders and abettors could be liable under section 10(b)." Bettina M. Lawton & Catherine Botticelli, *New Weapon in the SEC's Arsenal: Secondary Liability After* Central Bank, BUS. LAW TODAY, July/Aug. 1995, at 34; *see also* Steinberg, *supra*, at 489 (observing that *Central Bank of Denver* decision "swept away decades of lower court precedent that nearly universally recognized the propriety of" aiding and abetting liability under both section 10(b) and Rule 10b-5).

[181] *See, e.g.*, Melder v. Morris, 27 F.3d 1097, 1104 n.9 (5th Cir. 1994).

[182] *See supra* note 2 and accompanying text.

[183] *See Central Bank*, 511 U.S. at 191.

[184] *See supra* note 102.

[185] MISS. CODE ANN. § 75-71-725 (2000).

facts on which her liability is based.[186] The burden is on the defendant to prove her own reasonable diligence and lack of actual knowledge. It is neither necessary nor sufficient for the secondary violator to prove that she did not know that the sale or purchase was illegal; the key is whether she knew or should have known the *facts* that made the sale or purchase illegal.

In addition, while not truly a defense, an indirect seller found liable under section 719 has the right to contribution from anyone else who is jointly and severally liable with the indirect seller.[187]

d. Plaintiff's Actual Knowledge

Presumably, the defense afforded a primary violator by section 717(a)(2) who can prove that the plaintiff knew of the untruth or omission[188] is also available to a person being sued as secondarily liable for a primary violation of one of those provisions. However, section 719 does not explicitly mention the plaintiff's knowledge or lack thereof, and there are no published opinions on point.

Federal law, to which Mississippi courts look for guidance in interpreting and applying the MSA,[189] permits a control person—one class of persons covered by section 719—to avoid liability by proving that she "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action."[190]

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[186] MISS. CODE ANN. § 75-71-719. Federal law similarly excuses a control person who proves that she "had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which [her] liability . . . is alleged to exist." 15 U.S.C. § 77o (1994); *see supra* note 164.

[187] MISS. CODE ANN. § 75-71-719.

[188] *See supra* Part II.C.6.c.i.

[189] *See supra* note 14 and accompanying text.

[190] 15 U.S.C. § 78t(a). Exactly what constitutes "good faith" under federal law has been the subject of much debate, and considerable disagreement among (and even within) the circuits. *See* Rowley, *The Sky is Still Blue*, *supra* note 2, at 178-79 n.343. For an excellent discussion of scienter under federal securities law, see William H. Kuehnle, Commentary, *On Scienter, Knowledge, and Recklessness Under the Federal Securities Laws*, 34 HOUS. L. REV. 121 (1997).

There is no comparable federal defense to liability for materially aiding a primary violation of federal securities law because federal securities law no longer

E. Purchaser's Remedies

Whether she has succeeded in establishing a violation of the MSA's registration requirements, a fraudulent sale of securities, or both, section 717 affords a purchaser the following remedies in addition to those available at common law or in equity.[191] Because secondary liability under section 719 presumes a primary violation of section 717, a successful plaintiff should be entitled to the same remedies against a secondary violator as the plaintiff would recover if the defendant were a primary violator.

1. Rescission

A purchaser who still owns the securities is entitled to have the transaction rescinded and, upon making a tender of the securities, to recover from the seller the consideration she paid for the securities, plus interest from the date of payment, less "any income received on the security."[192] Tender is a nec-

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recognizes aiding and abetting liability. *See* Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 191 (1994); *supra* notes 180-81 and accompanying text.

[191] The rights and remedies provided by the MSA are in addition to any other statutory or common-law rights and remedies available to the purchaser. *See* MISS. CODE ANN. § 75-71-731. As the Mississippi Supreme Court eloquently explained in *Sanders v. Neely*, 19 So. 2d 424 (Miss. 1944):

> To the extent that statutes, by their terms and necessary implications, and the common law are not repugnant, they co-exist and will be given effect. The presumption is that the Legislature does not intend to make alterations in the law beyond what it explicitly declares, either by express terms or by necessary implication, and does not intend to overthrow fundamental principles or to infringe existing rights, without expressing or clearly implying such intention . . . . Statutes are not to be understood as affecting any change in the common law beyond that which is clearly indicated, either by express terms or by necessary implication from the language used . . . . This principle is so established by both reason and authority that we deem a citation of the numerous cases so holding in this and other jurisdictions to be unnecessary.

Id. at 426-27 (quotation and citation omitted). Nonetheless, while a purchaser may elect to sue, e.g., under both the MSA and common law, she is entitled to only one recovery for her same loss.

[192] MISS. CODE ANN. § 75-71-717(a); *see, e.g.,* Johnson v. Yerger, 612 F.2d 953, 958 (5th Cir. 1980) (applying precursor to section 717(a)(1), MISS. CODE ANN.

essary precondition to recovering consideration paid, and may be made at any time before entry of judgment.[193]

2. *Statutory Damages*

A purchaser who no longer owns the securities is entitled to recover: (1) "damages in the amount that would be recoverable upon a tender"—that is, the consideration paid for the security, plus interest thereon from the date of payment, less any amount the purchaser received on the security—(2) less the value of the security when the purchaser disposed of it and interest on that amount from the date the purchaser disposed of the security.[194]

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§ 75-71-31 (1972), *repealed by* Act of Apr. 23, 1981, ch. 521, § 418, 1981 Miss. Laws 1521, 1552). Interest is at the rate of eight percent (8%) per annum. MISS. CODE ANN. § 75-71-717(a) (2000).

A plaintiff suing for common law fraud, *see, e.g.*, Ezell v. Robbins, 533 So. 2d 457, 461 (Miss. 1988); Turner v. Wakefield, 481 So. 2d 846, 848-49 (Miss. 1985); or negligent misrepresentation, *see, e.g.*, Turner v. Terry, Nos. 1999-CA-00753-SCT, 1999-CA-01395-SCT, 2001 WL 171318, at *9 (Miss. Feb. 22, 2001), may seek rescission in appropriate cases. However, a common law plaintiff seeking rescission must do so promptly or she may lose the right to rescind:

> [T]he Gardners waived their option to rescind the contract [by which they purchased the stock of a corporation from the Littles] by managing and operating the corporation after discovery of the Littles' alleged fraud. "[S]tated in general terms, . . . assuming the fact of fraud, a contract obligation obtained by fraudulent representation is not void, but voidable. Upon discovery thereof, the one defrauded must act promptly and finally to repudiate the agreement; however, a continuance to ratify the contract terms constitutes a waiver." As with any contract, both parties have a responsibility to ensure that their interests are protected. In the instant case, the Gardners failed to do that. If the Gardners felt that the Littles misrepresented the corporation's net worth or acted in bad faith, then they were required to either promptly rescind the contract or affirm the contract and maintain an action in damages.

Gardner v. Little, 755 So. 2d 1273, 1276 (Miss. Ct. App. 2000) (quoting *Turner*, 481 So. 2d at 848-49 (citations omitted)).

[193] MISS. CODE ANN. § 75-71-721; *see, e.g., Johnson*, 612 F.2d at 958 (finding that plaintiffs made "legally sufficient tender" in their complaint filed in district court).

[194] MISS. CODE ANN. § 75-71-717(a). Interest, again, is at the rate of eight percent (8%) per annum. *See supra* note 192.

Prior to 1981, the MSA did not afford plaintiffs who had already sold their securities the opportunity of suing for damages arising from their purchase of unregistered securities. *See* MISS. CODE ANN. § 75-71-31 (1972), *repealed by* 1981

3. *Prejudgment Interest*

Section 717(a) explicitly includes prejudgment interest as part of the recovery due a plaintiff who still owns the security at the time she brings suit.[195] Prejudgment interest is implicit

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Miss. Laws, ch. 521, § 418; *see, e.g.*, Shivangi v. Dean Witter Reynolds, Inc., 107 F.R.D. 313, 323 (S.D. Miss. 1985) (applying section 75-71-31 and holding that, because plaintiffs "did not retender their stock, but instead sold it on the open market, they no longer have a remedy under the Mississippi Blue Sky Laws").

The statutory damages recoverable under section 717(a) are somewhat different from those available to those section 12(a)(2) plaintiffs who no longer own the securities that are the subject of their claim and to all claimants under section 10(b). Whereas the MSA's statutory damage remedy is based on disgorgement by the seller of the consideration it received from the purchaser, damages under section 12(a)(2) and section 10(b) are based on the difference between the value the purchaser paid for the security and the value of the security the purchaser received. *See, e.g.*, Randall v. Loftsgarden, 478 U.S. 647, 661-62 (1986); Affiliated Ute Citizens v. United States, 406 U.S. 128, 155 (1972).

In addition to a cash price paid for a security, "consideration paid" for purposes of section 12(a)(2) may include, *inter alia*, the value of (1) shares of some other tangible or intangible property given in exchange for shares of the security at issue, *see, e.g.*, Weft, Inc. v G.C. Inv. Assocs., 630 F. Supp. 1138, 1144 (E.D.N.C. 1986), *aff'd*, 822 F.2d 56 (4th Cir. 1987); (2) capital advanced to the issuer of the security in consideration for stock or stock options, *see, e.g.*, Mecca v. Gibraltar Corp. of Am., 746 F. Supp. 338, 348-49 (S.D.N.Y. 1990); (3) a controlling interest in a going concern ceded in exchange for securities, *see, e.g.*, Wigand v Flo-Tek, Inc., 609 F.2d 1028 (2d Cir. 1980); or (4) a legal claim foresworn in exchange for securities, *see, e.g.*, Foster v. Fin. Tech., Inc., 517 F.2d 1068, 1071 (9th Cir. 1975).

The measure of damages for common law fraud is the so-called "benefit of the bargain" rule, whereby the plaintiff may recover "the difference between the real and the represented value of the property." Hunt v. Sherrill, 15 So. 2d 426, 429 (Miss. 1943); *accord* Lloyd Ford Co. v. Sharp, 192 So. 2d 398, 400 (Miss. 1966). In the absence of other proof, the price paid by the plaintiff will establish the plaintiff's compensatory damages. *See Hunt*, 15 So. 2d at 429; *accord* Davidson v. Rogers, 431 So. 2d 483, 485 (Miss. 1983).

[195] MISS. CODE ANN. § 75-71-717(a) (2000); *see supra* note 192; *see, e.g.*, Johnson v. Yerger, 612 F.2d 953, 959 (5th Cir. 1980) (applying precursor to section 717(a)(1), MISS. CODE ANN. § 75-71-31 (1972), *repealed by* 1981 Miss. Laws, ch. 521, § 418).

Prejudgment interest is available to successful plaintiffs under section 12(a)(2). *See, e.g.*, Kaufman & Enzer Joint Venture v. Dedman, 680 F. Supp. 805, 813-14 (W.D. La. 1987); Monetary Mgmt. Group v. Kidder, Peabody & Co., 615 F. Supp. 1217, 1223 (E.D. Mo. 1985). Unlike section 59.115(2), which mandates prejudgment interest, the amount of prejudgment interest awarded to a successful section 12(2) plaintiff is a matter of judicial discretion. *See, e.g.*, Commercial Union Assurance Co. v. Milken, 17 F.3d 608, 615 (2d Cir. 1994); Sharp v. Coopers &

for a plaintiff who no longer owns the security, because she is entitled to recover "damages in the amount that would be recoverable upon a tender."[196]

4. Attorneys' Fees and Costs

A successful section 717 plaintiff is also entitled to recover costs and reasonable attorneys' fees.[197]

Lybrand, 649 F.2d 175, 193 (3d Cir. 1981). In exercising that discretion, a court may consider a number of factors, including: (1) the need to fully compensate the wronged party for actual damages suffered, *see, e.g.*, Osterneck v. Ernst & Whinney, 489 U.S. 169, 176 (1989); (2) the degree of personal wrongdoing on the part of the defendant, *see, e.g.*, *id.*; (3) whether the defendant has been unjustly enriched, *see, e.g.*, Ballay v. Legg Mason Wood Walker, Inc. No. 88-6867, 1990 WL 48195, at *1 (E.D. Pa. 1990); (4) whether the plaintiff delayed unduly in bringing or prosecuting the action, *see, e.g.*, *Osterneck*, 489 U.S. at 176; (5) the availability of alternative investment opportunities to the plaintiff, *see, e.g.*, *id.*; (6) the remedial purpose of the statute involved, *see, e.g.*, *Commercial Union*, 17 F.3d at 615; (7) considerations of fairness and the relative equities of the award, *see, e.g.*, *Osterneck*, 489 U.S. at 176; and (8) such other general principles as are deemed relevant by the court, *see, e.g.*, *Commercial Union*, 17 F.3d at 615.

[196] MISS. CODE ANN. § 75-71-717(a) (2000). In other words, the purchaser is entitled to recover the damages she would have recovered if she still owned the security. *See supra* note 194.

[197] MISS. CODE ANN. § 75-71-717(a); *see, e.g.*, Seaboard Planning Corp. v. Powell, 364 So. 2d 1091, 1096 (Miss. 1978) (applying precursor to current Mississippi Securities Act and finding that chancellor acted within his discretion in awarding attorneys' fees to defrauded purchasers); *see also, e.g.*, Felts v. Nat'l Account Sys. Ass'n, 469 F. Supp. 54, 65-66 (N.D. Miss. 1978) (applying section 25 of former Mississippi Securities Law, MISS. CODE ANN. § 75-71-25 (1972), *repealed by* 1981 Miss. Laws, ch. 521, § 418).

Section 11(e) of the 1933 Act, 15 U.S.C. § 77k(e) (1994), appears to authorize a successful section 12(a)(2) plaintiff to recover attorneys' fees at the trial court's discretion. *See, e.g.*, Guthrie v. Downs, Nos. 88-CV-75066-DT, 89-CV-71525-DT, 1991 WL 354939, at *6 (E.D. Mich. Aug. 7, 1991) ("Plaintiffs are, however, entitled under section 12(2) . . . to recover their costs of bringing these actions and reasonable attorney fees."), *aff'd*, 972 F.2d 350 (6th Cir. 1992). *But see, e.g.*, Junker v. Crory, 650 F.2d 1349, 1364 (5th Cir. 1981) ("Section 11(e) of the 1933 Act provides for a discretionary award of attorney's fees to the prevailing plaintiff in any suit brought under the Act, if the court determines that the defense advanced is frivolous, without merit, or brought in bad faith. *Absent such a finding, attorneys fees may not be awarded under section 11(e).*" (emphasis added)). Authorities are split over whether attorneys' fees are available to a successful section 10(b)/Rule 10b-5 plaintiff. *Compare, e.g.*, Cotton v. Slone, 4 F.2d 176, 181 (2d Cir. 1993) ("[A]ttorney's fees are not permitted in actions brought solely under section 10(b) of the Securities and Exchange Act. . . .") *and* Abell v. Potomac Ins. Co., 858 F.2d 1104, 1142 (5th Cir. 1988) ("[A]ttorney's fees are not available as a

5. Punitive Damages

The MSA does not provide for punitive damages.[198]

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matter of course under rule 10b-5"), *vacated on other grounds*, 492 U.S. 914 (1989), *with* SEC v. Capital Counsellors, Inc., 378 F. Supp. 224, 226 (S.D.N.Y. 1974) (holding that parties bearing costs of prosecuting or defending action in order to protect public investor are entitled to be reimbursed for such costs), *aff'd*, 512 F.2d 654 (2d Cir. 1975) *and* Chris-Craft Indus., Inc. v. Indep. Stockholders Comm., 354 F. Supp. 895, 903 (D. Del. 1973) ("[I]n some instances attorneys' fees [are] an appropriate remedy for private litigants who establish violations of the [1934 Securities Exchange] Act." (citing Mills v. Elec. Auto-Lite Co., 396 U.S. 375 (1970))).

Attorneys' fees are, likewise, generally unavailable to a prevailing plaintiff on a common law fraud or negligent misrepresentation claim, unless she can establish that she is entitled to punitive damages. *See, e.g.*, Holland v. Mayfield, No. 96-CA-01169-SCT, 1999 WL 353023, at *12 (Miss. June 3, 1999).

[198] Punitive damages are, likewise, unavailable to plaintiffs who successfully prosecute a claim under section 12(a)(2) of the 1933 Securities Act, 15 U.S.C. § 77*l*(a)(2) (Supp. V 1999), *see* Hill York Corp. v. Am. Int'l Franchises, Inc., 448 F.2d 680, 697 (5th Cir. 1971); *see also* Hunt v. Miller, 908 F.2d 1210, 1216 n.13 (4th Cir. 1990), or under section 10(b) of the 1934 Securities Exchange Act, 15 U.S.C. § 78j(b) (1994), or Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (2000), *see* 15 U.S.C. § 78bb(a) (Supp. V 1999); *Hunt*, 908 F.2d at 1216 n.13; Green v. Wolf Corp., 406 F.2d 291, 302-03 (2d Cir. 1968). However, section 78bb(a) does not prevent a plaintiff from recovering punitive damages on a pendent state law claim. *See Hunt*, 908 F.2d at 1216 n.13; Young v. Taylor, 466 F.2d 1329, 1337-38 (10th Cir. 1972).

Punitive damages are available at common law to a plaintiff who establishes by clear and convincing evidence that he was actually defrauded. *See* MISS. CODE ANN. § 11-1-65(1)(a) (2000); *see, e.g.*, *Holland*, 1999 WL 353023 at *11-12.

> The rule is firmly established in Mississippi, that punitive damages are recoverable not only for willful and intentional wrong, but for such gross and reckless (conduct) as is, in the eyes of the law, the equivalent of willful wrong. The award of punitive damages, and the amount thereof, if any, rests in the discretion of the trier of the facts.

Felts, 469 F. Supp. at 69 (quotation and citations omitted).

> In all cases involving an award of punitive damages, the fact finder, in determining the amount of punitive damages, shall consider, to the extent relevant, the following: the defendant's financial condition and net worth; the nature and reprehensibility of the defendant's wrongdoing, for example, the impact of the defendant's conduct on the plaintiff, or the relationship of the defendant to the plaintiff; the defendant's awareness of the amount of harm being caused and the defendant's motivation in causing such harm; the duration of the defendant's misconduct and whether the defendant attempted to conceal such misconduct; and any other circumstances shown by the evidence that bear on determining a proper amount of punitive damages . . . .

6. *Injunctive Relief*

The MSA empowers the Secretary of State to seek an injunction to enforce the provisions of the MSA.[199] No such right is given to any private party.

F. Pre-Suit Rescission Offers

The MSA does not require a plaintiff seeking to sue for damages or rescission to afford the defendant the opportunity to make good on the plaintiff's economic damages or rescind the subject transaction before the plaintiff files suit. However, if an MSA defendant makes a qualifying rescission offer under section 717(b), the plaintiff may not sue for the violation that is the subject of the rescission offer.[200]

The formal requisites of a rescission offer to a buyer are set forth in detail in section 717(b). There is, to date, no published decision of any Mississippi court, nor any rule or interpretive ruling from the Secretary of State, which specifically

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MISS. CODE ANN. § 11-1-65(1)(e). "Punitive damages do not follow as the day the night every finding that a defendant has been guilty of fraud . . . . Punitive damages are assessed 'only in extreme cases.'" Gardner v. Jones, 464 So. 2d 1144, 1148 (Miss. 1985). Misrepresentations made negligently, rather than fraudulently, will not support punitive damages, *see, e.g.*, Finkelberg v. Luckett, 608 So. 2d 1214, 1220 (Miss. 1992), unless they rise to the level of gross negligence, *see, e.g.*, Jenkins v. CST Timber Co., 761 So. 2d 177, 180 (Miss. 2000).

[199] MISS. CODE ANN. § 75-71-715(3). In some cases, injunctive relief may be available to a section 12(a)(2) plaintiff, *see, e.g.*, Deckert v. Independence Shares Corp., 311 U.S. 282, 287-90 (1940); Hoxworth v. Blinder, Robinson & Co., 903 F.2d 186, 194-97 (3d Cir. 1990), or a section 10(b)/Rule 10b-5 plaintiff, *see, e.g.*, Chris-Craft Indus., Inc. v. Indep. Stockholders Comm., 354 F. Supp. 895, 903 (D. Del. 1973). As a general rule, a party requesting a preliminary injunction must show either: "(1) a likelihood of success on the merits and the possibility of irreparable injury, or (2) the existence of serious questions going to the merits and the balance of hardships tipping [sharply] in [its] favor." MAI Sys. Corp. v. Peak Computer, Inc., 991 F.2d 511, 516 (9th Cir. 1993) (quotation omitted). The first showing represents a continuum in which "the required degree of irreparable harm increases as the probability of success decreases." *MAI Systems*, 911 F.2d at 516; *accord* Am. W. Airlines, Inc. v. Nat'l Mediation Bd., 119 F.3d 772, 777 (9th Cir. 1997), *cert. denied*, 523 U.S. 1021 (1998). Injunctive relief may also be available to a plaintiff alleging common law fraud. *See, e.g.*, Guastella v. Wardell, 198 So. 2d 227 (Miss. 1967).

[200] MISS. CODE ANN. § 75-71-717(b).

addresses either the validity of a rescission offer made pursuant to section 717(b) or the consequences of a defendant's failure to make a rescission offer or a plaintiff's failure to accept one.[201]

III. CONCLUSION

The relevant provisions of the Mississippi Securities Act provide Mississippi plaintiffs with additional protections beyond those afforded by Mississippi common law or federal statutory law, and, generally speaking, they do so on what are more generous terms.

As an initial matter, a plaintiff suing under section 717(a)(2) of the MSA may do so at any time within two years after she actually or constructively discovered the existence of her claim[202]—regardless of how much time has elapsed since she purchased the securities in question or since her cause of action actually accrued.[203] Limitations periods for common law fraud and negligent misrepresentation claims run three years from the date the plaintiff's cause of action accrued,[204] regardless of when or whether the plaintiff discovered the existence of her claim,[205] subject to equitable tolling due to the defendant's fraudulent concealment of the facts necessary for the plaintiff to discover the existence of her claim.[206] A plaintiff suing under federal securities law must do so within three years after her cause of action accrued, but in any case within one year after she actually or constructively discovered the basis for her claim—even if the one-year discovery period expires before the three-year default limitations period.[207] Thus, unless a plaintiff discovered the existence of her claim less

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[201] *See generally* Michelle Rowe, *Rescission Offers Under Federal and State Securities Law*, 12 J. CORP. L. 383 (1987); Stephen G. Christianson, Annotation, *What Gives Rise to a Right of Rescission Under State Blue Sky Laws*, 52 A.L.R. 5th 491 (1997).

[202] *See supra* notes 152-53 and accompanying text.

[203] *See supra* notes 152-58 and accompanying text.

[204] *See supra* note 152.

[205] *Id.*

[206] *Id.*

[207] *Id.*

than one year after it accrued, she would be afforded more time to seek redress under the MSA than under either Mississippi common law or federal securities law.

Plaintiffs suing under the MSA need not prove that they relied on the defendant's misrepresentation or omission in order to have their purchase rescinded or to recover damages,[208] whereas plaintiffs suing for fraud or negligent misrepresentation must do so,[209] as must plaintiffs suing under Rule 10b-5.[210] Likewise, plaintiffs suing under the MSA,[211] like those suing for negligent misrepresentation,[212] need not prove the defendant's state of mind at the time of the transaction, whereas a plaintiff suing for common law fraud[213] or under Rule 10b-5[214] must prove that the defendant acted with requisite scienter. Neither reliance nor scienter are elements of a section 12(a)(2) claim.[215] Thus, a plaintiff suing under the MSA has an easier principal case to make than one suing under Mississippi common law or under Rule 10b-5, and no harder a case to make than a plaintiff suing under section 12(a)(2).

Plaintiffs alleging common law fraud may recover punitive damages unavailable to plaintiffs suing under the MSA, the Mississippi common law of negligent misrepresentation, or federal securities law.[216] Plaintiffs suing under the MSA may recover reasonable attorneys' fees,[217] as may plaintiffs suing under the comparable provisions of federal securities law.[218] Plaintiffs suing for fraud or negligent misrepresentation, by comparison, are generally not entitled to recover attorneys' fees,[219] although an award of punitive damages to a successful fraud plaintiff may entitle her also to recover attorneys' fees.

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[208] *See supra* note 141 and accompanying text.
[209] *See supra* notes 138-39 and accompanying text.
[210] *See supra* note 140.
[211] *See supra* note 142 and accompanying text.
[212] *See supra* note 143.
[213] *See supra* note 143 and accompanying text.
[214] *See supra* note 144 and accompanying text.
[215] *See supra* note 141.
[216] *See supra* note 198 and accompanying text.
[217] *See supra* note 197 and accompanying text.
[218] *See supra* note 197.
[219] *Id.*

Control person liability under the MSA is—or, at least, should be—coterminous with control person liability under federal securities law,[220] although some have suggested reading the applicable federal statutes to permit imposing only proportionate liability on a control person who did not knowingly violate federal securities law,[221] whereas the MSA imposes joint and several liability without regard to the control person's knowledge or state of mind.[222] The MSA's other theory of "secondary" liability—namely, liability for materially aiding an MSA violation—has no federal counterpart.[223] Anyone is potentially subject to liability for materially aiding an MSA violation, regardless of their job title or status, whereas control person liability is, by its nature, limited to particular classes of persons or entities, based on their relation to the "primary" violator or to the "primary" violation. As a consequence, a plaintiff suing under the MSA may be able to hold persons accountable who are now beyond the reach of federal law.

Finally, and not to be overlooked, the MSA also creates liability for those who offer or sell unregistered securities that are not exempt from the MSA's registration provisions.[224] In so doing, the MSA provides Mississippi plaintiffs who did not purchase their unregistered securities from or in response to an offer made by "any means or instruments of transportation or communication in interstate commerce or of the mails"[225]—and, therefore, cannot sue under section 12(a)(1) of the 1933 Securities Act[226]—an opportunity for relief that is not available under federal law or Mississippi common law.

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[220] *See supra* notes 168-72 and accompanying text.

[221] *See supra* note 171.

[222] *See supra* notes 165 and 173 and accompanying text.

[223] *See supra* note 180 and accompanying text.

[224] *See supra* Part II.B.

[225] 15 U.S.C. § 77*l*(a)(1) (Supp. V 1999).

[226] *Cf.* Ayers v. Wolfinbarger, 491 F.2d 8, 16 (5th Cir. 1974) (holding that sales of stock in Alabama financial corporation to Alabama residents did not require registration under section 5 of 1933 Act, 15 U.S.C. § 77e (1994), and therefore could not give rise to liability under what is now section 12(a)(1), *id.* § 77*l*(a)(1), where no means or instruments of transportation or communication in interstate commerce or of mails were used to sell stock).

THE LITTLE RULE THAT NEVER WAS

Mississippi Rule of Evidence 301 Presumptions in Civil Actions and Proceedings

Tom R. Mason[*]

I. Where it Began

When the Mississippi Supreme Court entered its order on September 24th, 1985, adopting the Mississippi Rules of Evidence, Article III, entitled PRESUMPTIONS IN CIVIL ACTIONS AND PROCEEDINGS, consisted of one rule.[1] That rule supplies a single standard which purports to direct one uniform effect to be applied to all presumptions in civil cases unless otherwise directed by statute.[2] The rule provides:

> In all civil actions and proceedings not otherwise provided for by act of the Legislature or by these rules, a presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial upon the party on whom it was originally cast.[3]

The Mississippi Rules of Evidence were generally copied from

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[*] Professor of Law, School of Law, University of Mississippi. Many thanks to Lisa Anderson and Lendy Van Slyke, sterling members of the graduating class of 2000, who painstakingly searched every volume of the Mississippi Digest, topic by topic, to ferret out all the obscure and arcane cases about presumptions and made usable notes about those sources.

[1] *Preface to the* MISSISSIPPI RULES OF EVIDENCE; *see also* MISS. R. EVID. 301 (Mississippi presumption rule).

[2] MISS. R. EVID. 301.

[3] *See id.*

the Federal Rules of Evidence, in effect since 1975, with a few adaptations for local practices. Mississippi Rule of Evidence 301 was no different. It was a substantive copy of Federal Rule of Evidence 301, adapted only to reflect that it was a state rule, referring to acts of the Mississippi Legislature instead of Congress.[4]

Since the rules went into effect in 1986, the Mississippi appellate courts have decided many civil cases which involved presumptions but have applied Rule 301 only once.[5] It has generally been ignored, and its existence seems an obvious mistake. The effort here is to trace briefly the state of the law of presumptions when the rule was erroneously adopted, look at some of the cases decided since Rule 301 became effective, review the various approaches to the problem taken by other states and to suggest the rule needs to be changed to reflect the law as it is or be abolished.

The Appendix to this article is an attempt to provide a complete and comprehensive catalog of all the presumption rules which exist in Mississippi, both statutory and court made, with an easy-to-use Table of Contents. It is hoped that it will be a useful resource for the bench and the bar.

Undoubtedly some presumptions have been missed, as they seem to exist in every nook and cranny of the law and are sometimes obscurely referenced. Readers are invited to let the writer know of any presumption rules they know of which are not included. If justified, an addendum to the Appendix may be published in the future to provide the most complete catalog of presumptions possible.

II. The "Bursting Bubble" From Federal Rule of Evidence 301

The federal rule incorporated the so-called "bursting bubble" effect for all presumptions, and was the result of a surprising amount of debate and communications between the House of Representatives, the Senate, the Conference Committees of

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[4] *Compare* Fed. R. Evid. 301 *with* Miss. R. Evid. 301.

[5] *See infra* note 41 and accompanying text.

Congress and the Supreme Court Advisory Committee.[6] Surprising in that it would not have been expected that members of Congress knew much about or would be very interested in this arcane and abstruse topic.

Federal Rule of Evidence 301 represented a choice by Congress between the weak "bursting bubble" effect for all non-statutory presumptions and the stronger effect which was recommended in the proposed rule forwarded by the Supreme Court for consideration by the Congress.[7] The rule passed by Congress gives all non-statutory presumptions a weak effect. This means that once a party favored by a presumption puts on believable evidence of the basic facts raising the presumption, only the burden of producing evidence shifts to the opposing party. If that party presents contradictory evidence, then the presumption vanishes, leaving only the inferences which might be drawn from the proven basic facts. If no evidence is presented against the presumption, the jury would be instructed that they should presume the ultimate fact. If contradicting evidence is offered, the jury is instructed that the burden of persuasion rested on the originally burdened party and might be further instructed that they can "infer" the ultimate fact from the basic facts proven.[8]

Federal Rule of Evidence 301, as submitted to Congress after approval by the Supreme Court with the advice of its Advisory Committee, would have given a uniformly stronger effect to all presumptions. This would have shifted both the burden of going forward and the burden of persuasion to the party opposing when the basic facts proven gave rise to the presumption of the ultimate fact. The trial court thus would have instructed the jury that the opposing party had the burden of persuasion regarding the nonexistence of the fact which was

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[6] JACK B. WEINSTEIN & MARGARET A. BERGER, WEINSTEIN'S FEDERAL EVIDENCE, historical app., §§ 301 app. 01[1]0[4] (Joseph M. McLaughlin, ed., Matthew Bender, 2d ed. 1997).

[7] *Id.* § 301 app. 01[3].

[8] H.R. CONF. REP. No. 93-1597, at 2 (1974). This is the so-called Thayer rule, suggested by Professor Thayer before the turn of the twentieth century. JAMES B. THAYER, A PRELIMINARY TREATISE ON EVIDENCE AT THE COMMON LAW 336-43 (Boston, Little, Brown & Co. 1898).

carried by the presumption.[9]

The clear disagreement between the Congressional committees, made up of politicians, and the Supreme Court, with its Advisory Committee, including respected judges, lawyers, and law professors, should have caused some serious reflection prior to Mississippi's adoption of the rule chosen by the politicians. Apparently it did not.

The comment to Mississippi Rule of Evidence 301 is a single, terse paragraph which attempts to explain how the rule is to function.[10] There is no recognition of, nor any consideration expressed for, the long and rich history in Mississippi's jurisprudence of applying many presumption rules and giving different presumptions different treatment in how they affect the respective burdens of proof.

III. MISSISSIPPI'S RULES BEFORE MISSISSIPPI RULE OF EVIDENCE 301

The full history of the Mississippi Supreme Court's pre-rule handling of presumptions is covered in the Appendix. Suffice it to say that the Mississippi Supreme Court had dealt with hundreds of cases in which it applied scores of common law presumption rules and accorded them differing effects, usually without explanation of why the presumption and why that effect. A few examples will give a sense of the variety of subject matters where presumptions existed, and the varied effects which they had been given before the Mississippi Rules of Evidence were adopted.

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[9] *See* WEINSTEIN & BERGER, *supra* note 6, at historical app. §§ 301 app. 01[1]-[2]. This is the so-called Morgan theory of presumptions, suggested in Edmond M. Morgan, *Presumptions*, 12 WASH. L. REV. 255, 280-81 (1937), and also the rule recommended by the National Conference of Commissioners on Uniform State Laws, Uniform Rule of Evidence 301, and adopted by a number of states in lieu of the federal rule.

[10] MISS. R. EVID. 301 cmt.

A. Weak or Ordinary Presumptions[11]

There were many presumptions which carried the weak effect of only shifting the burden of presenting evidence to the opponent. This gets the favored party by a directed verdict on the presumed fact; if contradictory proof is offered, the question on that fact goes to the jury. It is debatable whether it is appropriate for the judge to instruct the jury that it may infer the ultimate fact from the proven underlying facts.[12]

Examples are:

-It was presumed that when a chauffeur allowed another person to drive a car while it was in the chauffeur's care, the chauffeur was within the scope of his duties.[13]

-It is presumed that a person loves life and will not commit suicide.[14]

-It is presumed that an instrument is a deed and not a mortgage when the grantee takes possession under the instrument.[15]

-A person is presumed to intend to do what he does.[16]

-A contract is presumed to have been entered into freely.[17]

-When an attachment is levied on the property of a debtor it is presumed that the debt was paid.[18]

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[11] The titles or names ascribed here to the categories of presumptions are the writer's, not the court's, but adopted for ease of reference to the different types of presumptions here and in the appendix.

[12] Julian P. Alexander, *Presumptions: Their Use and Abuse*, 17 MISS. L.J. 1 (1945). This is a wonderfully written article by a then Justice of the Mississippi Supreme Court arguing the view that all presumptions vanish when contradicting proof is offered, leaving the jury to decide the logical inferences which might be drawn from the basic facts with no instruction about such inferences, regarding such instructions to be a comment on the evidence. *Id.* at 17-19.

[13] Slaughter v. Holscomback, 147 So. 318, 321 (Miss. 1933).

[14] State *ex rel.* Richardson v. Edgeworth, 214 So. 2d 579, 585 (Miss. 1968).

[15] Bethea v. Mullins, 85 So. 2d 452, 456 (Miss. 1956).

[16] Bates v. Brevard-Woods Stave Co., 76 So. 553, 553 (Miss. 1917).

[17] Singer v. Tatum, 171 So. 2d 134 (Miss. 1965).

[18] Benson v. Benson, 24 Miss. 625, 629 (Miss. 1852).

B. Strong Presumptions

A number of presumptions had been given the stronger effect of shifting to the opponent both the burden of presenting evidence, and also the burden of persuasion, once the favored party had shown evidence of the underlying facts and the presumption had thus emerged. The illustrations here shift to the opponent the burden of persuading the factfinder the presumed fact does not exist by a preponderance of the evidence.

Examples are:

-A party (of competent age) to a contract is presumed to have the mental capacity to contract.[19]

-Where the parties had a ceremonial marriage it is presumed that they gave consent and that all essentials existed for a valid marriage.[20]

-A child between the ages of seven and fourteen is presumed to be incapable of negligence.[21]

-When a husband buys property with his wife's money, it is presumed to be held in a resulting trust.[22]

C. Very Strong Presumptions

Many presumptions have the effect of shifting both burdens to the opponent but also to enhance or increase the burden on the opponent to disprove the presumed fact by a higher level of persuasion, usually by clear and convincing evidence, but sometimes by persuading beyond a reasonable doubt.

Examples are:

-Where the fiduciary of a testator becomes the beneficiary of the will, it is presumed to have been procured by undue influence, and clear and convincing evidence is required to rebut the presumption.[23] The same presumption is applied when a fiduciary procures a contract from one who trusted him,[24] or from a deed.[25]

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[19] Parkinson v. Mills, 159 So. 651, 654 (Miss. 1935).

[20] Smith v. Weir, 387 So. 2d 761, 763 (Miss. 1980).

[21] Johnson v. Howell, 56 So. 2d 491, 492 (Miss. 1952).

[22] Ford v. Am. Home Fire Ins. Co., 5 So. 2d 416, 417 (Miss. 1942).

[23] Croft v. Alder, 115 So. 2d 683, 686 (Miss. 1959).

[24] Hendricks v. James, 421 So. 2d 1031, 1043 (Miss. 1985).

-It is presumed that parties to a contract have the capacity to contract; clear and convincing evidence is required to rebut the presumption.[26]

-Election returns are presumed to be valid and proper, requiring clear and convincing evidence to rebut them.[27]

-It is presumed that a subsequent marriage is valid and any previous marriage was dissolved by death or divorce; this is rebuttable only by "competent" evidence.[28]

-A child born or conceived during a marriage is presumed to be the legitimate child of the husband and wife; proof beyond a reasonable doubt is required to rebut this presumption.[29]

-A properly acknowledged instrument is presumed to be authentic because the acknowledgment imports verity and presumptively states the truth; clear and convincing evidence is required to rebut this presumption.[30]

-When a grantor's signature is placed on an instrument by another, the grantor is presumed to have adopted it as his own, and clear and convincing evidence is required to rebut it.[31]

D. Conclusive (irrebuttable) Presumptions

Finally, there were presumptions recognized before the Mississippi Rules of Evidence which were conclusive. These presumptions can be recast as rules of substantive law as shown below.

Examples are:

-A child below the age of seven is presumed incapable of negligence or contributory negligence.[32] Rule: A child be-

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[25] Mullins v. Ratcliff, 515 S.2d 1183, 1191 (Miss. 1987).

[26] Parkinson v. Mills, 159 So. 651, 654 (Miss. 1935).

[27] Lopez v. Holleman, 69 So. 2d 903, 910 (Miss. 1954). The experiences of November 2000, suggest that Florida could benefit from this rule.

[28] Erwin v. Hodge, 317 So. 2d 55, 57 (Miss. 1975).

[29] Moore v. Smith, 172 So. 317, 318 (Miss. 1937).

[30] Jones v. Minton, 141 So. 2d 564, 565 (Miss. 1962).

[31] *Jones*, 141 So. 2d at 566.

[32] Pascagoula St. Ry. & Power Co. v. Brondum, 50 So. 97, 104 (Miss. 1909).

low the age of seven cannot be negligent.[33]

-A purchaser of land is presumed to know what is on the face of documents in his chain of title.[34] Rule: A purchaser is charged with knowledge of all information in his chain of title.[35]

-It is presumed that an easement was acquired by adverse possession from proof of adverse continuous use for more than fifty years.[36] Rule: Fifty years of continuous adverse use establishes title to an easement by adverse possession.[37]

The Mississippi Supreme Court had thus adopted and applied many rules of presumptions and had given them differing effects. Most were given much more weight than the single weak effect mandated by Mississippi Rule of Evidence 301.

IV. Decisions After the Rules—Mississippi Rule of Evidence 301 is Ignored

The Mississippi courts have, since 1986, decided many cases in which presumption rules were applied,[38] but have only cited Rule 301 in three cases and appear to have applied it only once. In the first case to cite Rule 301, the court dealt with the procedural rule that, on a motion to dismiss, the well-pleaded allegations of the complaint are presumed to be true.[39] The court held that when evidence is offered the presumption vanishes, citing Rule 301.[40] This was obviously not an evidentiary presumption rule.

The only case in which Rule 301 appears to have been applied was a forfeiture case in which the court considered a statute providing that money found in close proximity to drugs is presumed to be forfeitable and, citing Rule 301, held the defendant's evidence rebutting the presumption was sufficient

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[33] *Brondum*, 50 So. at 104.

[34] Magee v. Holmes, 70 So. 2d 60, 64 (Miss. 1954).

[35] *Magee*, 70 So. at 64.

[36] McCain v. Turnage, 117 So. 2d 454, 455 (Miss. 1960).

[37] *McCain*, 117 So. 2d at 455.

[38] *See generally* app..

[39] Jones v. Chandler, 592 So. 2d 966, 971-72 (Miss. 1991).

[40] *Jones*, 592 So. 2d at 972 n.5.

to make it disappear.[41] In the only other case citing Rule 301, it was held inapplicable in a criminal case involving the presumption of sanity because the rule applies only to civil actions.[42]

In the scores of cases involving presumptions decided since Rule 301 was adopted, the Mississippi Supreme Court has appeared to be oblivious to Rule 301, or has consciously chosen to ignore it.[43] It seems probable that the court, particularly in dealing with the traditionally strong presumptions which shift the burden of persuasion, has considered simply the weak effect of Rule 301 to be inappropriate for the subject matter considered. This would be because it was determined logic or policy demands more weight be given to the rule of presumption. The court obviously has decided to continue to apply the rules as developed in the long history and tradition of its jurisprudence, and to ignore Rule 301.

The failure of the Mississippi Supreme Court to apply a rule which it adopted and which clearly is expressed as a rule of the court is a bad example for the judges of the lower courts who are expected to follow the rules, orders and decisions of the Mississippi Supreme Court; it must be confusing to them when the application of a presumption is an issue in their cases. That failure should be a disappointment to those who expect the court to epitomize adherence to the rule of law and are aware of this obscure phenomenon. The rule should be abolished or a rule adopted which reflects the state of the law the court has chosen to follow.

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[41] Neely v. State *ex rel.* Tate County, 628 So. 2d 1376, 1380-82 (Miss. 1995).

[42] Billiot v. State, 655 So. 2d 1, 14-15 (Miss. 1995).

[43] See the many cases decided since 1986 and cited in the appendix and recognize that the citations in the appendix are to only the most recent cases. There were many more which are not cited. For example, there have been seventeen involving the presumption of undue influence when a fiduciary becomes the beneficiary of a will, which shifts the burden to the beneficiary to persuade the factfinder there was no undue influence by clear and convincing evidence, directly contrary to Rule 301.

V. EXPERIENCE IN OTHER STATES—FEDERAL RULE OF EVIDENCE 301 IS THE MINORITY

It is reported that forty-one states have now adopted or enacted rules of evidence patterned after the Federal Rules of Evidence.[44] The treatments of the presumption rules have varied.

A. Federal Rules of Evidence (weak single rule) Approach

Thirteen states, including Mississippi, adopted the substance of Federal Rule of Evidence 301.[45] Four other states appear to have adopted this approach, but language in their rules makes them subject to judicial decisions.[46] This makes their presumption rule a default rule, applied by trial courts only when there is no controlling precedent, and preserves to the appellate courts the flexibility of giving presumptions variable effects without running counter to the rule.

B. Uniform Rule (strong single rule) Approach

Thirteen states rejected Federal Rule of Evidence 301 and chose instead to adopt the stronger rule which shifts the burden of persuasion to the party opposing all presumptions.[47] This was the rule proposed by the Supreme Court to Congress and recommended in the Uniform Rules of Evidence.[48]

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[44] *See* 1 WEINSTEIN & BERGER, *supra* note 6, T-1.

[45] *See id.* at T-26 to T-28.

[46] *Id.*; *see* ALASKA R. EVID. 301 and N.C. R. EVID. 301 (both stating "not otherwise provided for by . . . judicial decision"); N.H. R. EVID. 301 (stating "unless otherwise provided for by . . . case law"); *see also* VT. R. EVID. 301 (stating "except as otherwise provided by law"). The Oklahoma rule has similar language, but its rules place it in the variable rule group, independent of such language. *See* OKLA. R. EVID., OKLA. STAT. ANN. tit. 12, § 2303 (West 2000) (stating "except when otherwise provided by law").

[47] *See* 1 WEINSTEIN & BERGER, *supra* note 6, at T-26 to T-29. Arkansas, Delaware, Louisiana, Maine, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oregon, Utah, Wisconsin and Wyoming follow this approach. *See id.*

[48] *See id.* at T-2 to T-6.

C. Variable (flexible rule) Approach

Ten states followed this approach. Six of these states rejected the Federal Rule of Evidence 301 and adopted rules which give varying effects to different presumptions.[49] The effect to be given generally depends on either the probative strength of the basic facts used to prove the presumed fact or the importance of the policy driving the presumption. To these are added the four states which make their rule subject to judicial decisions.[50]

D. No Rule (common-law flexibility) Approach

Five states, in accepting most of the Federal Rules of Evidence, rejected Rule 301 and adopted no rule for presumptions.[51] The courts in these states thus continue to deal with presumptions in the common law fashion, and may assign such effect as is appropriate for each presumption rule.

Of the remaining ten jurisdictions which have not adopted something similar to the Federal Rules of Evidence,[52] California and Kansas have their own evidence codes with presumption rules which provide presumptions may be given varying effects.[53] These are discussed later. The other eight states have no rule and, thus, are free to give each presumption rule the effect deemed appropriate, i.e., the variable approach.

This puts Mississippi in the minority of thirteen states which, on paper, adhere to giving the weak effect of Rule 301 to all presumptions.[54] Twenty-five states have the variable (flexible) approach either by rule, by having their rule subject to

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[49] *See id.* at T-26 to T-29. Alabama, Florida, Hawaii, Iowa, Oklahoma and Rhode Island follow this approach. *See id.*

[50] *See supra* note 46 and accompanying text.

[51] *See* 1 WEINSTEIN & BERGER, *supra* note 6, at T-26 to T-29. Arizona, Pennsylvania, Tennessee, Texas and Washington follow this approach. *See id.*

[52] *See id.* California, Connecticut, D.C., Georgia, Illinois, Kansas, Massachusetts, Missouri, New York and Virginia follow this approach. *See id.*

[53] *See* CAL. EVID. CODE §§ 600-70 (West 1995); KAN. STAT. ANN. § 60-414 (2000).

[54] *See supra* note 45 and accompanying text.

judicial decisions, or by having no rule.[55] To these states Mississippi might be added because the variable approach is the reality of its jurisprudence.

These, then, represent the several models which the Mississippi Supreme Court might consider in deciding what to do about its impotent Rule 301. The following discussion will describe in more detail the rules from some other states, comment on them, and recommend what approach Mississippi should take.

VI. WHAT KIND OF RULE?

A. The No-Rule Approach

Mississippi Rule of Evidence 301 could be abolished, simply leaving the laws of presumptions to the common law decisional application and evolution which is the present reality of the way the court administers these laws. That would at least make the Mississippi Rules of Evidence consistent with the reality of the situation. There are, however, disadvantages to having no rule at all.

The rules, in principle at least, should have a primary function of guiding trial judges in handling their cases. Without a rule, a trial judge who is faced with a claim that a presumption favors a party in a suit can look to precedent and apply that, if there is any. A party, though, may propose a presumption rule which has support from other states, but which has not been approved by the appellate courts of Mississippi, or is provided by a statute which has never been construed, or is just a common-sense proposition based on sound logic and policy, but not supported by any authority. The judge is faced with a decision as to whether to apply an unprecedented common law rule (which is not a question with a statute) and if so, how to apply it—in other words, what effect to give it.

A rule which identifies the factors to consider in deciding whether a presumption should exist, such as logic, policy, fairness, availability of proof or just to provide a decision when

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[55] *See supra* notes 49-51 and accompanying text.

there is no proof,[56] could help in deciding whether a presumption should be recognized. The rule could also assist judges in deciding the effect to be given the unprecedented or statutory presumption when it is applied and what, if any, instructions might be appropriate.

Rules are also important in assisting attorneys in predicting the problems of proof which may arise in their cases, understanding the burdens of proof and planning and arranging the presentation of their evidence at trial. It would be advantageous to have a rule which assists attorneys in predicting when and what presumptions might affect their cases, knowing what burdens are shifted by a presumption, what the burden of persuasion will be and what instructions, if any, should be given about a presumption. Such a rule would also provide the parameters for their arguments, thereby assisting the court in deciding the various issues which may arise about rules of presumptions.

There are unanswered questions about presumptions which should be resolved by a rule. One taxing question is whether or not to instruct the jury about a presumption of the weak (ordinary) variety which shifts only the burden of presenting evidence to the party opposed. It seems clear that if the base facts are shown, and no evidence is offered to rebut those facts, then the jury is to be instructed to presume the ultimate fact if it finds the base facts exist. But, when there has been evidence offered to rebut the base facts or the presumed fact, then should the jury be instructed, and if so, how? A rule should give guidance here.

Another issue involves the effect of a statute which describes or defines a *prima facie* case on some fact issue. The Mississippi Supreme Court has held that such a statute creates a presumption.[57] But what kind of presumption? Does it vanish when rebutting proof is offered, or should the jury be instructed about any inferential value the *prima facie* facts may have? This should also be addressed in a rule.

A somewhat obscure issue exists regarding when and why

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[56] KENNETH S. BROWN, ET AL., MCCORMICK ON EVIDENCE § 343 (4th ed. 1992).
[57] *See infra* Part VIII.A.

a presumption, which shifts both burdens of proof, should also raise the level of persuasion required to rebut the presumed fact to clear and convincing evidence or to beyond a reasonable doubt. As the examples given above and the cases in the Appendix show,[58] there are a number of these kinds of rebuttable presumptions. It would assist the trial judges, and likely improve administration of these laws, for a rule to identify the factors to be considered and the process to be utilized for deciding whether or not a new presumption should require a higher burden of persuasion for rebuttal.

Another problem which should be resolved by a rule is the rarely occurring situation in which conflicting presumptions appear to apply in a single case. For example, there is a statutory presumption of death after seven years of unexplained absence and also a presumption of the continuation of life,[59] there is a presumption that a marriage is valid and a conflicting presumption that a second marriage of a party is valid,[60] people are presumed to have acted lawfully,[61] but also presumed to intend the natural consequences of their acts.[62] These conflicting presumptions might be claimed by the parties in a given case to apply in their favor. The question would be which, if either, of the conflicting presumptions prevails when the basic facts which raise both are shown in a case. A presumption rule should give guidance for resolving this problem.

It would also be wise to resolve the question of what presumption rules are to be applied in the occasional cases when a state court is applying federal law as the controlling substantive law. Some states have explicitly provided that in such cases the federal laws of presumptions apply.[63]

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[58] *See supra* notes 47-48 and accompanying text; *see generally infra* app.
[59] *See infra* app. at 63, 69.
[60] *See infra* app. at 87.
[61] *See infra* app. at 86.
[62] *See infra* app. at 84.
[63] *See, e.g.*, ALA. R. EVID. 302; HAW. R. EVID. 302.

B. The Single Rule Approach

The sole advantage of the single rule approach is its relative simplicity and ease of understanding, since it gives all presumptions the same effect. Mississippi has tried the experiment of having a single rule supposedly designed to apply to all presumptions.[64] Rule 301 shifts only the burden of producing evidence to the opponent but leaves the burden of persuasion on the originally burdened party.[65] This approach has not worked.

The other single rule approach adopted by a number of states, as noted above, is the strong effect rule which shifts both burdens to the opposing party and justifies an instruction about the presumption.[66] This is the rule proposed to Congress by the United States Supreme Court and rejected.[67] There is no more reason to expect this to work in Mississippi than the experiment which has failed because experience has proven inconsistent with that rule also. There are many statutory and common-law presumptions which are not based on strong policies or compelling logic, but are adopted because of the greater access to proof by one party or just to have a decision made when proof is difficult to obtain. These have been given the weak or ordinary effect by the Mississippi Supreme Court, while others have been given the stronger effect.[68]

It appears that the Mississippi court has made the decision, conscious or not, that presumptions are to be given the varying effect, as indicated by the cases decided before and after the adoption of the rules.[69] There has been no indication that the complexity of administering a multi-effect set of rules has concerned the court or even been recognized by the court as a problem. It thus seems appropriate that the Mississippi Rules of Evidence should accurately reflect the real and applied state

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[64] MISS. R. EVID. 301.
[65] *See id.*
[66] *See supra* notes 47-48 and accompanying text.
[67] *See supra* note 48 and accompanying text.
[68] *See generally infra* app.
[69] *See supra* notes 13-37 and accompanying text.

of the law.

Drafting a multi-effect variable rule which would fit the reality of the present law and give guidance and assistance to trial judges and lawyers should begin by considering the various models which have been adopted by the several states which retained or adopted the variable rule approach.

C. The Variable Rule Approach: Flexibility Reserved to the Courts

Alaska, North Carolina, New Hampshire and Vermont have reserved flexibility by the simple expedient measure of making their single effect presumption rules expressly subject to "judicial decisions," "case law" or "law."[70] The effect is to make the stated rule a default rule to be applied by trial courts absent precedent, but to reserve to appellate courts the prerogative and flexibility to recognize different presumptions and give each one the effect deemed appropriate without running afoul of their own rules.

This approach could be workable, and the rules could be expanded to resolve some of the problems regarding instructions, enhanced burdens of rebuttal and conflicting presumptions. Its weakness is that it commits the trial judge to either the weak or the strong effect for a new and yet unapproved presumption when a different approach may be appropriate. It would be better to give the trial judge the authority and guidance to decide which effect is most appropriate for a presumption, considering identified factors which bear on the question, including authority from other states, statutes, other writings and certainly the good judgment of the judge.

D. The Oklahoma Variable Rule Approach—Logic Based

Unlike most states' rules, the Oklahoma Evidence Code does not define and distinguish conclusive presumptions, but deals only with rebuttable presumptions.[71] It first provides clear definitions of "presumption," "basic fact," "presumed fact"

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[70] *See supra* note 46 and accompanying text.

[71] OKLA. EVID. CODE, OKLA. STAT. ANN. tit. 12, §§ 2301-2305 (West 1993).

and "inconsistent presumptions."[72] It then directs that basic facts may be established by pleadings, stipulation, judicial notice or evidence.[73]

The substantive core of the rules provides, in effect, that presumptions arising from basic facts which have "any probative value of the existence of the presumed fact" shift the burden of persuasion to the opposing party.[74] If the basic fact "does not have any probative value of the existence of the presumed fact" then the presumption vanishes if the opposing party introduces sufficient rebutting evidence; the issue is thus decided as if no presumption had been operable.[75] The final section in the article provides that, if inconsistent presumptions arise, the court will apply the one "founded on weightier considerations of policy or logic," if one is.[76] If not, then both are disregarded.[77]

The commentary to the rules indicates this variable approach to a presumption rule was taken after a cataloging of presumptions from Oklahoma cases.[78] This cataloging revealed that both weak and strong effects had been given to different presumptions, both statutory and common-law, and that the rule was designed to comport with the existing state of the law.[79] Kansas, a state without a set of rules patterned after the Federal Rules of Evidence, appears to have adopted the Oklahoma approach in its presumption rule.[80]

The principal weakness of this approach is that when deciding whether the presumption shifts the burden of persuasion, it confines consideration to the probative value of the basic facts used to prove the presumed fact. This calls solely on logic, reason and common sense or experience to be considered in making the choice.

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[72] *See id.* § 2301.
[73] *See id.* § 2302.
[74] *See id.* § 2303.
[75] *See id.*
[76] *See id.* § 2305.
[77] *See id.*
[78] *See id.* § 2303, evidence subcommittee's note.
[79] *See id.*
[80] KAN. STAT. ANN. § 60-414 (1994).

There are other important and generally recognized factors involved in recognizing a presumption. These include public policy, greater access to proof by one party, fairness and making a decision when there is no direct evidence available on an issue.[81] These should also be considered when deciding whether to give a presumption a weak or a strong effect. They are also important in deciding whether a shifted burden of persuasion should be raised to a higher level in order to rebut the presumed fact.

Although this is a good model that is relatively simple to understand and apply, a more comprehensive approach would more accurately describe the reasons for the laws and provide a more complete guide for their application.

E. The California Variable Rule Approach—Policy-based

The California Evidence Code is one of the three most respected comprehensive sets of evidence rules, along with the Uniform Rules of Evidence and the Federal Rules of Evidence. It was enacted in 1965, and like the Federal Rules of Evidence, it was drafted by committee with a reporter, then considered and passed by the legislature. Publications include similar commentary by the committee and legislative history.[82]

The chapter on Presumptions and Inferences is very detailed, including some forty-five sections.[83] It includes a definition[84] and examples of conclusive presumptions,[85] with which we are not concerned here. However, it also separates rebuttable presumptions into those which affect the burden of producing evidence (weak effect) and those which affect the burden of proof (strong effect).[86] It is these with which we are concerned. It provides that a statute specifically defining *prima facie* evidence creates a rebuttable presumption.[87]

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[81] *See supra* note 56 and accompanying text.

[82] JACK B. WEINSTEIN ET AL., EVIDENCE, 1999 RULES, STATUTE AND CASE SUPPLEMENT, Foundation Press.

[83] CAL. EVID. CODE §§ 600-670 (West 2000).

[84] *See id.* § 601.

[85] *See id.* §§ 620-624.

[86] *See id.* § 601.

[87] *See id.* § 602.

"A presumption affecting the burden of producing evidence [weak effect] is a presumption established to implement no public policy other than to facilitate the determination of the particular action in which the presumption is applied."[88] Such a presumption's effect "is to require the trier of fact to assume the . . . presumed fact unless and until evidence is introduced which would support a finding of its nonexistence."[89] If there is sufficient rebutting evidence, then the issue is determined on all the evidence "without regard to the presumption,"[90] with appropriate inferences drawn from the basic facts.

"A presumption affecting the burden of proof is a presumption established to implement some public policy other than to facilitate the determination of the particular action in which the presumption is applied . . . ."[91] Such a presumption's effect "is to impose upon the party against whom it operates the burden of proof as to the nonexistence of the presumed fact."[92]

Other sections of the code give many illustrations or examples of each type of rebuttable presumption.[93]

Florida, Hawaii and Alabama appear to have patterned their presumption rules on the principles of the California rules.[94] Each is differently organized and differs in text and detail. Florida and Alabama do not include the lists of example presumptions, while Hawaii does.[95] The main similarity is that they all appear to adopt policy as the sole criteria for distinguishing between rebuttable presumptions.[96] In all three jurisdictions, presumptions affecting only the burden of producing evidence are based on no policy other than facilitating

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[88] *Id.* § 603 (West 2000).

[89] *Id.* § 604.

[90] *Id.*

[91] *Id.* § 605.

[92] *Id.* § 606.

[93] *See id.* §§ 620-670 (listing some thirty-two different presumptions of three types defined by code).

[94] *See* ALA. R. EVID. 301; FLA. STAT. ANN. §§ 90.303-90.304 (West 2000); HAW. R. EVID. 301-05; *see also supra* notes 83-93 and accompanying text.

[95] *See* ALA. R. EVID. 301; FLA. STAT. ANN. §§ 90.303-90.304; *cf.* HAW. R. EVID. 303-04 (listing specific examples of presumptions).

[96] *See* ALA. R. EVID. 301; FLA. STAT. ANN. § 90.303; HAW. R. EVID. 303-04.

that action. Those affecting the burden of proof (persuasion) are those based on public policies other than solely facilitating the action. Florida did this the easy way by simply defining presumptions affecting only the burden of producing evidence and then casting all that do not fit that definition into the other category.[97] Alabama's is the most succinct, having only a single rule with six sub-parts.[98]

The comprehensiveness of the California approach and the fact that it recognizes and illustrates the varying effects which may be given to presumptions makes it a helpful model. Its apparent weakness is that it bases the distinction between the weak and strong rebuttable presumptions solely on policy. As mentioned above there are several other important considerations which may influence that decision, and these should be identified in a useful rule. The listing of the many examples of each type of presumption in the California rules[99] would more properly be placed in the official commentary to a rule.

F. Rhode Island Variable Rule Approach—Multi-factored

Rhode Island generally follows the federal approach, but in adopting its presumption rules,[100] it seems to have picked up on the California model but improved it. It provides that "a presumption imposes on the party against whom it is directed either (A) the burden of producing evidence . . . or (B) the burden of persuasion . . . ."[101] It then describes the first type as one established to implement no public policy other than to facilitate the action (sounds like California).[102] That rule, however, goes on to state in effect that such presumptions may arise based on logic, better availability of evidence to one party or to get a decision made when there is no direct evidence on the presumed fact.[103] It thus recognizes more of the traditional reasons for creating presumptions. These rules next describe

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[97] FLA. STAT. ANN. §§ 90.301-90.304.
[98] *See* ALA. R. EVID. 301.
[99] *See supra* notes 83-93 and accompanying text.
[100] R.I. R. EVID. 301-06.
[101] R.I. R. EVID. 302.
[102] R.I. R. EVID. 303.
[103] *Id.*

the procedural effect of a weak presumption and resolve the dilemma of inconsistent presumptions.[104] Finally, it provides that strong presumptions are only those which implement some public policy other than to facilitate the action, while giving four illustrations of such policies.[105]

This set of rules from Rhode Island is the only model incorporating various factors which may influence the recognition of new presumptions and the effects to be given to them. However, it seems to be deficient as an exact model for Mississippi since it limits strong presumptions to those based on some public policy, and requires that all presumptions based on logic, availability of evidence or the need to make a decision be given the weak effect.

There are presumptions in Mississippi which shift the burden of persuasion and sometimes raise the burden of rebuttal, thus appearing to be based on factors other than public policy or other factors in combination with policy. The presumption of death after seven years of unexplained absence, which shifts and raises the burden of persuasion,[106] seems based as much on reason, common experience and the need to arrive at a decision without direct evidence as on policy. The presumption of the authenticity and truth of the matters stated in an acknowledgment on a deed, which requires clear and convincing evidence to rebut,[107] seems to be based more on logic, reason and common experience than on any policy. Most acknowledgments are probably truthful, and no clear policy favoring either side of that issue comes to mind. That a child born during a marriage is presumed legitimate is based on very strong public policy as well as on much common experience and fairness.[108]

Presumption rules for Mississippi, therefore, should be

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[104] R.I. R. EVID. 304.

[105] R.I. R. EVID. 305. The illustrations are: "establishment of a parent and child relationship, the validity of marriage, the stability of titles to property, or the security of those who entrust themselves or their property to the administration of others." *Id.*

[106] *See infra* app. at 68.

[107] *See supra* note 30 and accompanying text.

[108] *See supra* note 29 and accompanying text.

more broadly based and more comprehensive to reflect the current state of the law and to allow growth and evolution consistent with the changing state of the law. The examples of other states can be effectively used as partial guides.

VII. Recommended Content for Mississippi Rule of Evidence Article III

This is not an attempt to draft rules, but an attempt to suggest content which reflects the choice the Mississippi Supreme Court has made to have a flexible approach which gives variable effects to presumptions.[109] Presumptions are obscure and complex creatures of the law which suggest that a rule should be a primer on that law. It is better to err on the side of including more detail than the contrary.

A. Definitions Needed

Presumption—A rule of law established by legislation, regulations or court decisions which permits or requires the finding of a presumed fact when identified basic facts are found to exist.

Comment: This differs from the definitions in other variable rule states[110] in mentioning that presumptions may be established by legislation, regulations or court decisions. The other rules just refer to "law."[111] It seems proper to mention these other sources to make clear that their application is governed by these rules, absent direction in those positive laws. The other states also uniformly say that the law "requires" the presumed fact to be found if the basic facts are found. That seems appropriate for conclusive presumptions, but inconsistent with the concept of a rebuttable presumption in which the opposing party may carry the burden of proving its nonexistence. Thus, this definition provides that the authority may establish a rule which "permits or requires" the presumed fact to be found.

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[109] *See supra* notes 54, 55 and accompanying text.

[110] *See, e.g.*, Ala. R. Evid. 301; Cal. Evid. Code § 601 (West 2000).

[111] Ala. R. Evid. 301; Cal. Evid. Code § 601.

Basic Fact—a fact or facts which are identified in a presumption rule as sufficient to prove a presumed fact.

Presumed Fact—the ultimate fact which may or must be found to exist if the basic facts are found to exist.

Inference of Fact—a fact which may be logically found to exist from the basic facts proven, but is not required to be found by a presumption rule.

Favored Party—a party to an action in whose favor a presumption exists to prove facts which that party may or must prove under the initially assigned burdens of proof.

Opposing Party—a party to an action against whom a presumption operates to prove facts against that party.

Burdens of Proof—the burden of producing evidence on an issue and the burden of persuasion on an issue.

Comment: This list of defined terms is considerably more detailed than in the variable rules of the other states.[112] It is thought appropriate that there should be established a common vocabulary for most of the key terms in the substance of the rules.

B. Bases of Presumptions

Presumptions are, and may be, established: (1) to support or implement public policies or interests; (2) when the basic facts have probative value to prove the presumed fact because of applied logic, reason and common experience; (3) in the interest of fairness to a party; (4) because one party appears to have superior access to or control of evidence on a disputed fact issue; (5) to provide a decision on a fact issue when direct proof is not available on the issue; (6) for such other bases as may be found appropriate and just.

Comment: None of the other states included anything approaching this comprehensive identification of the reasons why presumptions are found to exist. California, and the states which followed it, refer only to policy, either the policy of facilitating the determination of that action or

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[112] *But see supra* notes 71-73 and accompanying text.

other policies.[113] Oklahoma refers only to the probative value of the basic facts.[114] Rhode Island comes closest, mentioning several factors which may call for establishing a weak presumption, but limiting strong presumptions to those established to implement a public policy.[115]

It seems likely identification of the various bases for presumptions will be most helpful to trial judges in deciding whether or how to apply an unprecedented presumption rule, or an uninterpreted statute, and to attorneys in briefing and arguing on such issues.

C. Types of Presumptions and Effects

Conclusive Presumptions—rules of law which apply when basic facts are shown to exist and which, for compelling reasons of policy, may not be rebutted by any amount or quality of evidence, and which are applied in trials as are any other applicable rules of law.

Rebuttable Presumptions—all other presumptions which are divided into the following categories:

1. *Weak/Ordinary Presumptions*[116]—presumptions which, when sufficient evidence of the basic facts is presented, shift only the burden of producing evidence from the favored party to the opposing party, but the burden of persuasion remains on the favored party. These are based primarily on considerations other than public policies or interests.

Effect: (a) If the opposing party does not offer sufficient evidence to support a finding of the nonexistence of the basic facts or the presumed fact then the trier of fact will accept the presumed fact as established, and a jury will be instructed accordingly.

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[113] *See supra* note 91 and accompanying text.

[114] *See supra* notes 74, 75 and accompanying text.,

[115] *See supra* notes 104, 105 and accompanying text.

[116] It is recognized that these names for presumptions are not recognized in the law, but continue to be used here for sake of clarity. It would be helpful if the rules adopted some title or name for each of the types of presumptions for ease of reference in trial court orders and findings and appellate decisions.

Comment: This effect is consistently stated by all authorities.

(b) If the opposing party does offer such sufficient evidence then, if the basic facts are probative of the presumed fact, a trier of fact may infer the presumed fact to exist, and a jury may be instructed accordingly without referring to the presumption. If the basic facts are not probative of the presumed fact, then their effect as proof of the presumed fact is to be disregarded, and a jury will receive no instruction regarding any inference which may be drawn from the basic facts.

Comment: This is an issue on which there is dispute. The approach taken here is drawn from the Oklahoma Evidence Code.[117] It seems "probative value" (logic-reason-common experience) is the appropriate criteria for deciding whether any effect remains when the presumption is sufficiently rebutted. If the probative value of the basic facts was enough to justify the presumption, then it should survive at least for that inferential value, and the jury should be reminded of the inference they may draw if the basic facts are found to exist so they do not feel compelled to accept the rebutting evidence which may appear more direct.

2. *Strong Presumptions*—presumptions which, when sufficient evidence of the basic facts is presented, shift both the burden of producing evidence and the burden of persuasion on the fact presumed to the opposing party. These presumptions are established when there are substantial and strong bases for them.

Effect: The burden of persuasion is imposed on the opposing party to persuade the trier of fact, by a preponderance of the evidence, that the basic facts or the presumed facts do not exist; a jury will be instructed accordingly.

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[117] OKLA. STAT. ANN. tit. 12, § 2303 (West 1993).

3. *Very Strong Presumptions*—presumptions which shift both burdens to the opposing party. The bases for these presumptions are very substantial, and include important public policies or interests; therefore, the burden of persuasion should be raised to require clear and convincing evidence, or proof beyond a reasonable doubt, of the nonexistence of the presumed fact.

Effect: The trier of fact will require the higher standard of persuasion of the nonexistence of the presumed fact, and a jury will be instructed accordingly.

Comment: None of the other evidence codes or rules mention this type of presumption. Mississippi has recognized many of these, as shown in the Appendix,[118] and it seems appropriate to identify them and distinguish the bases for them from those supporting the normal strong presumptions.

D. Inconsistent Presumptions

If presumptions which are inconsistent appear to apply in a case, the court will apply the one which is based on the more important or weightier considerations. If neither is so based, then neither will be applied.

Comment: Several of the other state's rules resolve this dilemma,[119] and it would be helpful to trial judges to have direction on it.

E. Statutory and Regulatory Presumptions

Presumption rules which are established by statute or regulation will be given the effect required by that law. If no effect is required, then the court will apply such presumptions in accordance with these rules.

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[118] *See infra* app. at 42.

[119] *See supra* notes 76, 77 and accompanying text; *see also* ALA. R. EVID. 301(d); R.I. R. EVID. 304(b).

F. Statutory Prima Facie Rule

If a statute describes or defines *prima facie* proof of a fact, it will be given the effect of a weak presumption which shifts only the burden of producing evidence.

> *Comment:* States addressing this say simply the statute creates a rebuttable presumption but not which type. This provision is to give a statutory *prima facie* case the normal effect of that evidence, i.e., being sufficient to survive a motion for directed verdict and to create a factual issue for the jury. Whether an inference instruction would be justified would depend on the probative value of the basic facts, as with other weak presumptions.

G. Rules in Federal Law Cases

When federal law provides the rules of decision on issues in a case tried in a Mississippi state court, the federal rules of presumptions will apply.

> *Comment:* This definition is consistent with the rules from other states which bothered to address these rare cases, except this proposed rule makes clear that federal presumptions rules are to be applied *only* on federal law issues, and not on issues controlled by state law.

This is the suggested content for a rule or set of rules which reflect the actual state of the law of presumptions in Mississippi. It is recommended that the court consider amending the present Article III of the Mississippi Rules of Evidence to reflect these realities.

VIII. APPENDIX AND COMMENTARY

This appendix is in two sections. Section I catalogs and comments on evidentiary presumptions, the true topic of this article. Section II presents numerous rules, adopted either by the Mississippi Supreme Court or Legislature, which place the burden of convincing a court that the contrary to the presumed principle is true. These rules are often expressed in terms of presumptions, but are not evidentiary presumptions. Rather, they are procedural devices which generally favor the validity of the actions and proceedings of local and state officials, agencies and trial courts by placing the burden on the opposition of convincing a court that their acts were not valid or lawful. Forty-five of those rules were found.

A. Explanation: Vocabulary

The rules of presumptions in Mississippi civil cases are listed below with citations to either cases or statutes which are the bases for them. These rules were found in an attempt to make a thorough and comprehensive search of the Mississippi Digest and the Mississippi Code.

In statutes, the rules are frequently stated in terms of the proof of certain facts being *prima facie* proof of the ultimate fact. The Mississippi Supreme Court has treated such statutes as creating a presumption of the ultimate fact. This is illustrated by the scores of cases under former section 13-1-119 of the Mississippi Code which was repealed in 1989.[120] That act provided that it was *prima facie* evidence of the railroad's negligence to prove injury or damages from a running train.[121] The court routinely referred to that as a presumption of negligence which cast the burden on the railroad to rebut. The legislative preference for drafting in terms of a *prima facie* case will be followed here, in referring to such statutory rules, with the understanding that they create presumptions of the ultimate facts indicated. All statutory citations below are to the 2000

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[120] MISS. CODE ANN. § 13-1-119 (repealed 1989).

[121] *See id.*

Supplement to the Mississippi Code.

The rules are organized under alphabetically listed topics with some cross references where the topics seem to overlap. In general, the cases cited are the most recent cases applying the rules. There are, with some rules, so many cases that attempting to cite them all would result in long and unhelpful string cites. A researcher can trace earlier history of the rules from those cases cited. The listings include some federal cases in which Mississippi rules were applied or predicted.

The commentary is to indicate, in the rare cases where any has been described, either the reasons why the presumptions were held to exist and the effect of the presumptions or the writer's ideas about the reasons for the rules and their effects.

The effects of the presumption rules, common law and statutory, may be of four types, as follows:

Rebuttable Presumptions:

1. **Ordinary (Weak) Presumptions**. These are the type of presumptions described by Mississippi Rule of Evidence 301.[122] If the underlying facts are found to exist, these establish a *prima facie* case on the presumed fact and shift only the burden of producing evidence against the presumed fact to the opposing party. The jury may be instructed that they may find the presumed fact based on the underlying facts (this is not made clear in any case found, especially those in which the opposing party presents rebutting evidence), but the burden of persuasion rests on the party who originally had it, i.e., the party favored by the presumption. The statutes which define a *prima facie* case create this type of presumption. Where not otherwise indicated in the cases it is here assumed that the rules create this type of presumption. Eighty-seven common law and forty-nine statutory ordinary presumptions were found.

2. **Strong Presumptions.** If the underlying facts are found to

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[122] *See* MISS. R. EVID. 301.

exist these rules establish a *prima facie* case on the presumed fact and shift both the burden of producing evidence and the burden of persuasion that the presumed fact does not exist to the opposing party. The jury should be instructed that if the underlying facts are found to exist, then they should find the presumed fact to exist unless persuaded by the opposing party that it does not exist. The burden of persuasion that the fact does not exist is sometimes left at the standard of a preponderance of the evidence, but is sometimes raised to a higher level of persuasion which gives the next category. Twenty-four common law and nine statutory strong presumptions were found.

3. **Very Strong Presumptions.** These rules have the same effect as strong presumptions, except the burden of persuasion against the presumed fact is increased to clear and convincing evidence or some similar level, and with a very few, to proof beyond a reasonable doubt. This enhanced burden of proof is to be included in the instructions placing the burden of disproving the presumed fact on the party opposing the presumption. Twenty-four common law and two statutory very strong presumptions were found.

4. **Conclusive Presumptions.** No evidence will be sufficient to rebut the presumed fact. There are a surprising number of these. Twenty common law and fourteen statutory conclusive presumptions were found.

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SECTION I
EVIDENTIARY PRESUMPTIONS

Abandoned Personalty

1. *That property held or owed by a bank or financial institutions is abandoned* is presumed from lack of a claim or contact by the person owed the property within certain time periods for different types of deposits, checks or instruments as indicated in the statute.[123] An ordinary presumption.

2. *That funds held by or owing by a life insurance corporation under a life or endowment insurance policy which has matured or terminated are abandoned* is presumed if unclaimed and unpaid for more than five years after becoming due and payable.[124] An ordinary presumption.

3. *That the last known address of the person entitled to the (presumably abandoned) funds held by an insurance corporation is the same as the last address of the insured or annuitant according to the records of the company* is presumed.[125] A presumption affecting the burden of proof (strong presumption).

Comment: The statute provides that the presumption is one "affecting the burden of proof." This is assumed to be intended to place the burden of persuasion on the one contesting the fact.

4. *That funds held by a utility are abandoned* is presumed when a deposit by a subscriber has remained unclaimed for more than five years.[126] An ordinary presumption.

5. *That stock or other intangible ownership interest in a business association is abandoned* is presumed when a dividend, distribution or other sum payable as a result of the interest has gone unclaimed for more than five years and there has been no communication by the owner and there have been at least five dividends, distributions or other sums paid which were unclaimed.[127] An ordinary presumption.

6. *That any intangible personal property and any income or*

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[123] MISS. CODE ANN. § 89-12-5 (1999).
[124] *See id.* § 89-12-7(1).
[125] *See id.* § 89-12-7(2).
[126] *See id.* § 89-12-9.
[127] *See id.* § 89-12-11.

increment thereon, held by a fiduciary for the benefit of another is abandoned is presumed unless the owner has, within five years, increased or decreased the principal, accepted payment from it, corresponded in writing about it or otherwise indicated an interest in it.[128] An ordinary presumption.

7. *That intangible property held by a business association, federal, state or local government or governmental subdivision, agency or entity, or any other person or entity is abandoned* is presumed when the owner has not claimed or corresponded in writing within five years after the date it was to be paid or delivered and the last known address of the owner is unknown and the person or entity issuing the intangible property is in this state or any subdivision of it or is incorporated, organized, created or otherwise located in this state.[129] An ordinary presumption.

8. *That intangible personal property, held in the ordinary course of the holder's business, including income or increment thereon, not otherwise covered by this chapter (89-12) is abandoned* is presumed when unclaimed for more than five years after it was payable or distributable.[130] An ordinary presumption.

9. *That tangible or intangible personal property, including choses in action, debts owed or entrusted funds, held by the federal government or any federal agency, officer or appointee was abandoned in this state* is presumed when the last known address of the owner is in this state and the property is unclaimed for five years.[131] An ordinary presumption.

10. *That there was intention to abandon saw logs, sawn or hewn timber, lumber, boat, building or other floatable thing of value* is *prima facie* shown by proof that such property has been relinquished, deserted or left for a period of three years with no effort to salvage such property.[132] An ordinary pre-

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[128] *See id.* § 89-12-13.

[129] *See id.* § 89-12-14 (2000).

[130] *See id.* § 89-12-15 (1999).

[131] *See id.* § 89-12-16. For additional considerations, requirements and procedures for presumed abandoned personal property, see *id.* §§ 89-12-17 to -55.

[132] *Id.* § 89-17-5.

sumption.

Accretions

1. *That there was gentle erosion and accretion of lands* is presumed.[133] An ordinary presumption.

Acknowledgements

1. *Authenticity and the truth of the matters stated in the acknowledgment on an instrument* is presumed requiring clear and convincing proof to rebut.[134] It arises from proof of the certificate of acknowledgment on an instrument, whether by an officer in usual form or by the affidavit of a witness.[135] A very strong presumption.

2. *That the officer making an acknowledgment certified the truth and was not acting wrongfully or with fraud* arises from proof of the acknowledgment requiring clear and convincing evidence to rebut.[136] A very strong presumption.

Comment: No reasons for these presumptions are given in the cases. They may be based on the policy of having stability in titles or the policy disfavoring claims of fraud. It may be, in fairness, to place the burden on a party who challenges an instrument after a long time has passed and witnesses have died. It is also logical that most acts of notaries are honestly done and truthfully show the acts of the others involved and the statements made.

Adoption

1. *That a person participating in the requirements of sections 93-17-201 through 93-17-223 (locating and revealing information about adoptions as permitted by law) acted in good faith* is presumed.[137] An ordinary presumption.

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[133] Robinson v. Humble Oil & Ref. Co., 176 So. 2d 307 (Miss. 1965) (citing United States Gypsum Co. v. Reynolds, 18 So. 2d 448, 449 (Miss. 1944)).

[134] Thompson v. Shell Western E.&P. Co., 607 So. 2d 37, 40 (Miss. 1992).

[135] *Thompson*, 607 So. 2d at 40.

[136] Nichols v. Saul's Estate, 165 So. 2d 352 (Miss. 1964).

[137] MISS. CODE ANN. § 93-17-211 (1994).

Adverse Possession

1. *That possession by a grantor is in subordination to the title of the grantee and not adverse* is presumed where a grantor continues in possession after a deed to the grantee.[138] An ordinary presumption.

2. *That possession is permissive or amicable* is presumed when by a person in filial or parental relation with the other party.[139] An ordinary presumption which disappears when the facts are shown.

Comment: No reasons are stated in the cases for these presumptions, but they seem to be grounded in the probabilities of the facts proven.

3. *That there was a grant from the sovereign or a private person* is presumed when there was possession as an owner for a long period of time.[140] Apparently a conclusive presumption.

Comment: This usually arises when the possessor of land can trace title back to a patent or tax deed, which is now lost or questionable, although it has been applied in cases in which the transaction was between private parties. The possession has been for a long period of time (fifty years or more), and this rule exists independently of the statute of limitations.

The reason, as far as the governments are concerned, is that the government should not profit from an error in the records and should not demand and collect taxes and then claim the taxpayer has no title. Unlike the statute of limitations this rule applies and can carry title against the sovereigns.

No reason has been stated for applying the rule as between private parties, but it is likely based in the logic that undisturbed possession for the long period of time is unlikely unless the occupant has a title.

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[138] Johnson v. Black, 469 So. 2d 88 (Miss. 1985).
[139] Randall v. Mitchell, 41 So. 2d 44 (Miss. 1949).
[140] Bd. of Trs. v. Rye, 521 So. 2d 900, 906 (Miss. 1998).

It is classed as apparently conclusive because it appears to decide the cases when the claimant shows such a long period of possession and the acts of ownership such as paying taxes. No evidence or argument of the lack of a clear documentary title will defeat the presumption of the grant to the claimant or her/his predecessors in title.

4. *That a lost deed was executed and delivered* is presumed.[141] An ordinary presumption.

Animals

1. *Knowledge of their dangerous propensities* is presumed of one who owns/keeps wild animals.[142] A conclusive presumption.

Comment: This is but another way of stating the substantive rule of law that the owner or keeper of wild animals is strictly liable for injuries they cause. The rule removes the element of scienter from the plaintiff's case and thus creates strict liability, as held in the case cited.

Attorney and Client

1. *That an attorney acts with the authority of his client* is presumed requiring a showing of fraud or mutual mistake to rebut.[143] A strong presumption.

Automobiles

1. *That a driver sees what is there to be seen* is presumed.[144] This is apparently a conclusive presumption.

2. *Negligence* may be presumed under the doctrine of *res ipsa loquitur* in an automobile accident case.[145] An ordinary presumption sometimes referred to as an inference. See **Negligence** for elements of *res ipsa loquitur.*

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[141] Hewling v. Blake, 70 So. 247 (Miss. 1915).

[142] Phillips v. Garner, 64 So. 735, 736 (Miss. 1914).

[143] Terrain Enters., Inc. v. W. Cas. & Sur. Co. 774 F.2d 1320, 1322 (5th Cir. 1988); Craft v. Burrow, 89 So. 2d 722, 726 (Miss. 1956).

[144] Boyd Const. Co. v. Bilbro, 210 So. 2d 637, 641 (Miss. 1968).

[145] Stringer v. Bufkin, 465 So. 2d 331, 334 (Miss. 1970); Johnson v. Foster, 202 So. 2d 520, 527 (Miss. 1967).

3. See **Employer/Employee** for presumptions about vicarious liability of employers.

Bailee/Bailor

1. *That the bailee's negligence caused damage or loss to goods* is presumed when goods were delivered to the bailee in good condition and thereafter found damaged or destroyed.[146] An ordinary presumption which was said to disappear when the facts were shown.

2. See **Carriers** for presumption of negligence of last carrier.

Bankruptcy

1. *That a bankrupt was insolvent ninety days before filing* is presumed on a claim of preferential transfer before filing.[147] An ordinary presumption.

Banks

1. *That banks know the signatures of depositors* is presumed.[148] Apparently a conclusive presumption as between the bank and the depositor.

Comment: This rule is corollary to the substantive rule that the bank bears the loss instead of the depositor if the bank accepts and pays a forged check on that account. It appears to be conclusive in that it decides the case against the bank.

2. See **Joint Tenants**.

Bastardy

1. *That the test results of genetic testing conducted by an expert are as shown on the report from the expert* is *prima facie* shown by the certified report filed in the court and there is no timely challenge to the test results or the court decides there is

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[146] Hamm v. F.B. Walker & Sons, Inc., 198 So. 2d 817, 818 (Miss. 1967).

[147] Pongetti v. Merchs. & Farmers Bank (Matter of Wellington Constr. Corp.), 82 B.R. 424, 427 (Bankr. N.D. Miss. 1987).

[148] First Nat'l Bank v. Deposit Guar. & Trust Co., 156 So. 2d 814, 816 (Miss. 1963).

no cause for further testing.[149] An ordinary presumption.

2. *That there is paternity by the alleged father* is presumed if the court finds that the probability of paternity, as calculated by experts as examiners of genetic tests, is 98 percent or greater.[150] A strong presumption requiring rebuttal by a preponderance of the evidence.

3. *The matter contained in a foreign determination of paternity* is conclusively proven by a certification of that determination by competent authority from the other state and is to receive full faith and credit.[151] A conclusive presumption.

Bills and Notes

1. *That all co-makers of a promissory note owe equal shares* is presumed.[152] An ordinary presumption.

2. *That a promissory note was made without fraud* is presumed.[153] An ordinary presumption.

3. *That the holder of a promissory note gave value and holds in due course* is presumed.[154] An ordinary presumption.

Comment: Presumptions such as these supported the reliability and negotiability of notes under the common law. They were not displaced by the Uniform Commercial Code (UCC) which specifically provides that the older laws are supplementary to the UCC unless specifically displaced by some provision of it.[155] The UCC does not include such rules of presumptions, and they therefore should continue in effect.

4. See **Uniform Commercial Code**.

Carriers

1. *That goods were damaged by the last carrier* is presumed

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[149] MISS. CODE ANN. § 93-9-23(3) (2000).

[150] *Id.* § 93-9-27(2) (1994).

[151] *Id.* § 93-9-30 (1994 & Supp. 2000).

[152] Williams v. Owen, 613 So. 2d 820, 829 (Miss. 1993).

[153] Thomas v. B. Rosenberg & Sons, 120 So. 2d 732, 733 (Miss. 1929).

[154] Tex. Plant Co. v. Milam, 180 So. 86, 87 (Miss. 1938); *see* Credit Indus. Co. v. Adams County Lumber & Supply Co., 60 So. 2d 790, 795 (Miss. 1952) (adding limitation that if negotiator's title is defective, holder must prove that he or his predecessor acquired title as holder in due course).

[155] MISS. CODE ANN. § 75-1-103 (1981 & Supp. 2000).

where there was a contract for continuous carriage and the last carrier does not furnish records of handling by all carriers within thirty days after demand.[156] Probably a conclusive presumption.

2. *That goods were damaged by the negligence of a carrier* is presumed when goods were delivered to carrier in good condition.[157] An ordinary presumption.

3. *That injury or damage to livestock was from the want of reasonable skill and care by a carrier* is *prima facie* shown by proof that the injury or damages occurred while in transit.[158] An ordinary presumption.

Children

1. *That a child is legitimate* (that the husband is the father) is presumed when the child was born during a marriage.[159] A very strong presumption requiring proof beyond a reasonable doubt to rebut.

2. *That a child is legitimate* is presumed even when born after a divorce but during the normal term for birth.[160] A very strong presumption.

Comment: This presumption is said to be among the strongest known to law and is based on the strong policy favoring legitimacy of children. Earlier cases held that it could be rebutted only by proof beyond a reasonable doubt that the father did not have access to the mother or was impotent. The more recent cases recognize that paternity can be proven or disproven to a high degree of probability by scientific testing evidence.

3. *That it is in the best interests of a child to be in the custody of the natural parents* is presumed.[161] An ordinary presumption which is lost when the natural parent voluntarily relinquishes custody of a child. The parent then can reclaim

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[156] *Id.* § 77-9-35.

[157] Hornsby v. Logaras, 49 So. 2d 837, 839 (Miss. 1951).

[158] MISS. CODE ANN. § 13-1-121 (1972 & Supp. 2000).

[159] Rafferty v. Perkins, 757 So. 2d 992, 995 (Miss. 2000); Dep't of Human Serv. v. Gaddis, 730 So. 2d 1116, 1117 (Miss. 1998).

[160] Moore v. Smith, 172 So. 317, 318 (Miss. 1937).

[161] Grant v. Martin, 757 So. 2d 264, 266 (Miss. 2000).

custody only by clear and convincing evidence of its being in the child's best interest.

4. See also **Parent and Child** and **Divorce.**

Civil Rights

1. *That an employer intentionally discriminated against the plaintiff* is presumed from a *prima facie* showing of disparate treatment in the employment of the plaintiff who is a member of a protected class.[162] An ordinary presumption.

Collisions (Admiralty)

1. *That operators of a "sheering" vessel were negligent* is presumed from one vessel making a "sheering" movement into the path of another.[163] A strong presumption.

2. *That negligence of the lessee of a barge caused the sinking of the barge* is presumed where the barge sank while in the possession of the lessee.[164] A strong presumption.

3. *That negligence of a tug owner caused a collision* is presumed when the tug hit a known submerged cable.[165] A strong presumption.

4. *That the operator of a vessel was negligent* is presumed when a vessel hits a fixed object.[166] A strong presumption.

Compromise and Settlement

1. *That a written settlement agreement is the entire agreement* is presumed absent evidence of fraud.[167] A strong presumption.

Comment: This appears to be an alternative statement of the parole evidence rule.

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[162] Thornbrough v. Columbus & Greenville R.R. Co., 760 F.2d 633, 738-39 (5th Cir. 1985).

[163] Harcon Barge Co. v. M/V J.B. Chauvin, 487 F. Supp. 187, 191 (N.D. Miss. 1979).

[164] Hollinger v. Warrior Tombigbee Trans. Co., 572 F. Supp. 1291, 1297 (N.D. Miss. 1983).

[165] S. Cent. Bell, Inc. v. Merritt Dredging Co., 726 F. Supp. 1061, 1071 (S.D. Miss. 1989).

[166] Canal Barge Co. v. Griffith (Petition of M/V Elain Jones), 480 F.2d 11, 17 (5th Cir. 1973).

[167] Howard v. Sun Oil Co., 294 F. Supp. 24, 26 (S.D. Miss. 1967).

Concealment of Evidence

1. *That evidence would be unfavorable to a party* is inferred from failure to call a witness or produce materials within the control of the party.[168] An inference which deserves an instruction.

Comment: Although cast as an inference in the cases, it is included because an instruction is warranted by the proven facts.

2. See **Spoliation of Evidence**.

Condominiums

1. *That the transfer or conveyance was of the entire condominium* is presumed from any transfer or conveyance of a unit or an apartment, office or store which is a part of the unit.[169] An ordinary presumption rebuttable by an express statement in the document.

Continuity of Fact

1. *That a fact, continuous in nature, continues until the contrary is shown* is presumed.[170] An ordinary presumption.

Contracts

1. *That consideration was given* is presumed when the contract recites consideration.[171] A strong presumption requiring a clear preponderance of the evidence to rebut.

2. *That a contract was freely entered into* is presumed.[172] An ordinary presumption.

3. *That parties had the mental capacity to contract* is presumed.[173] A strong presumption shifting the burden of persuasion to the other party.

Comment: No reason for these presumptions is mentioned

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[168] Fruehauf Corp. v. Trs. of the First United Methodist Church, 387 So. 2d 106, 112 (Miss. 1980).

[169] MISS. CODE ANN. § 89-9-11 (1999).

[170] Sparks v. S.E. Greyhound Lines, 173 F. Supp. 896, 899 (N.D. Miss. 1959), *rev. on other grounds*, 283 F.2d 44 (5th Cir. 1960).

[171] Daniel v. Snowdown Ass'n, 513 So. 2d 946, 950 (Miss. 1987).

[172] Singer v. Tatum, 171 So. 2d 134, 148 (Miss. 1965).

[173] Parkinson v. Mills, 159 So. 651 (Miss. 1935).

in the cases, but they can be seen to create presumed facts which logically are more likely to exist than not and place the burden of proof on the one contesting such a fact.

4. *That a contract is invalid* is presumed from existence of a fiduciary relationship between parties to the contract.[174] A very strong presumption requiring clear evidence of good faith, full knowledge and independent consent and action to rebut.

Comment: This type of presumption also exists in connection with wills and gifts from which a fiduciary benefits. The court never gives a reason for the rules but they can be seen to be supported by a strong policy of protecting people from those they trusted but who may take advantage of that trust, and therefore making the fiduciary prove he or she did not take advantage of the position.

5. *That a contract is irrevocable* is presumed.[175] An ordinary presumption.

Corporations

1. *That the corporate president has authority to execute notes for the corporation* is presumed.[176] An ordinary presumption.

2. *That the corporate president has the power to employ a person* is presumed.[177] An ordinary presumption.

Damages

1. *That a deceased child's income would have been the equivalent of the national average as set forth by the United States Department of Labor* is presumed.[178] An ordinary presumption.

Comment: The court, in creating this new presumption, stated that it was based in equity and fairness; that it was not equitable to limit the estimate of the economic potential of a deceased child to that of the child's parent or a

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[174] Hendricks v. James, 421 So. 2d 1031, 1042-43 (Miss. 1982).

[175] Warwick v. Matheney, 603 So. 2d 330, 336 (Miss. 1992).

[176] Moyse Real Estate Co. v. First Nat'l Bank of Commerce, 70 So. 821, 822 (Miss. 1916).

[177] Tupelo Hotel Co. v. Long, 126, 126 So. 6 (Miss. 1930).

[178] Greyhound Lines, Inc. v. Sutton, 765 So. 2d 1269, 1272 (Miss. 2000).

person from the same community.[179] The beginning assumption here is that the child would have attained at least the average economic potential as indicated in the statistics from the Department of Labor.[180] Either party may rebut this with evidence of the individual potential of that child.[181]

Death

1. *That a person is dead* is presumed from proof of seven years of unexplained absence absent evidence that he or she was alive during that time.[182] A strong presumption.

2. There is no presumption that a person absent for seven years died at any particular time.[183]

3. *That a person is presumed dead* is *prima facie* shown by a written finding by an officer or employee of the United States authorized to make such finding.[184] An ordinary presumption. (A certified copy of such a finding is *prima facie* proof that the record is authentic and that the officer or employee was authorized to make the finding.)[185]

4. *That life continues* is presumed until the evidence shows to the contrary.[186] An ordinary presumption.

5. See **Damages, Missing Persons** and **Survivorship**.

Deeds

1. See **Acknowledgments, Mortgages**.

2. *That a defective acknowledgment on an instrument of conveyance is good* is presumed from being of record for seven years.[187] Apparently a conclusive presumption.

3. *That an instrument of conveyance which bears no acknowledgment was acknowledged* is presumed from being of

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[179] *Sutton*, 765 So. 2d at 1276-77.
[180] *Id.* at 1277.
[181] *Id.*
[182] MISS. CODE ANN. § 13-1-23 (1972 & Supp. 2000).
[183] N.Y. Life Ins. Co. v. Brame, 73 So. 806, 809 (Miss. 1917)
[184] MISS. CODE ANN. § 13-1-25(1) (1972).
[185] *Id.* § 13-1-25(3).
[186] State v. Fabian, 263 So. 2d 773, 775 (Miss. 1977).
[187] MISS. CODE ANN. § 89-5-13(1) (1999).

record for ten years.[188] Apparently a conclusive presumption.

4. *That a deed was executed before a deed which was recorded later* is presumed from it being filed earlier.[189] An ordinary presumption.

5. *That a person owns property* is presumed from holding the deed.[190] An ordinary presumption.

6. *That a deed was delivered* is presumed from the recording of the deed or the grantee holding the deed.[191] An ordinary presumption.

Comment: Reasons are not given for the above rules, but they can be seen to rest on the policy favoring stability of titles and the probability that the presumed facts are more likely to be true than not.

7. *That there was no dishonesty or fraud in procuring a deed* is presumed from a facially valid and recorded deed.[192] A very strong presumption requiring clear and convincing evidence to rebut.

Comment: This rule, like others, supports the policy disfavoring claims and requiring strong proof of fraud.

8. *That there was undue influence exercised over the grantor in procuring a deed* is presumed when a fiduciary of the grantor obtains the deed.[193] A very strong presumption requiring clear and convincing evidence to rebut.

Comment: In the *inter vivos* gift case it does not have to be shown that the fiduciary was involved in suspicious circumstances in procuring the gift. This makes the presumption of undue influence in procuring *inter vivos* gifts even stronger than that invoked when the fiduciary becomes the beneficiary of a will.

9. *That a deed was invalid* is presumed when the grantors were illiterate and trusted the grantee to help them to avoid foreclosure.[194] Likely a strong presumption based on consider-

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[188] *Id.* § 89-5-13(2).
[189] Biglane v. Rawls, 153 So. 2d 665, 672 (Miss. 1965).
[190] Walters v. Patterson, 531 So. 2d 581, 584 (Miss. 1988).
[191] Greenlee v. Mitchell, 607 So. 2d 97, 107 (Miss. 1992).
[192] Jordan v. Warren, 602 So. 2d 809, 813 (Miss. 1992).
[193] Griffin v. Armana, 687 So. 2d 1188, 1192-93 (1996).
[194] Glenn v. Macon, 163 So. 2d 239, 249-50 (Miss. 1964).

ations similar to those involving undue influence by a fiduciary.

10. *That the grantor had the legal capacity to execute the deed* is presumed.[195] An ordinary presumption.

11. *That the grantor adopted or ratified the signature of another as her/his own* is presumed from a properly acknowledged deed.[196] A very strong presumption requiring clear and convincing evidence to rebut.

Comment: The reason for this is that the acknowledgment, presumed truthful, (see **Acknowledgements**) bears evidence that the grantor acknowledged the signature of another as her own. It is also in the interest of fairness to put a heavy burden on a party attacking the deed long after the transaction and original parties are often unavailable or memories have faded.

Defamation

1. See **Libel** and **Slander**.

Descent and Distribution

1. *That an intestate left heirs capable of inheriting* is presumed.[197] An ordinary presumption.

2. *That land deeded by a father to his child is an advancement* is presumed.[198] An ordinary presumption.

3. *That personalty delivered by a parent to a child is an advancement* is presumed.[199] An ordinary presumption.

Divorce

1. *That the place of domicile continues* is presumed once it is established.[200] An ordinary presumption.

2. *That co-owners of jointly owned property own equal shares* is presumed.[201] An ordinary presumption.

3. *That property acquired during marriage is marital prop-*

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[195] Richardson v. Langley, 426 So. 2d 780, 786 (Miss. 1983).
[196] Thompson v. Shell W. E. & P. Co., 607 So. 2d 37, 40 (Miss. 1992).
[197] Malone v. Pope, 196 So. 2d 319, 321 (Miss. 1940).
[198] Greene v. Greene, 110 So. 218 (Miss. 1926).
[199] Whitfield v. Whitfield, 40 Miss. 352, 368-69 (1866).
[200] Bilbo v. Bilbo, 177 So. 2d 772, 776 (Miss. 1938).
[201] Johnson v. Johnson, 550 So. 2d 416, 420 (Miss. 1989).

erty is presumed.[202] An ordinary presumption.

4. *That a party to a divorce is incurably insane which justifies a divorce* is *prima facie* presumed from affidavits of two doctors filed in the proceedings that the party is a mentally disturbed person.[203] An ordinary presumption.

5. *That a party who was insane at the time of the marriage and continuing insane thereafter did not know that he was insane at the time of the marriage* is presumed.[204] An ordinary presumption.

Comment: This presumption aids the statute making insanity grounds for divorce from one not knowing of it at the time of the marriage.

6. *That joint custody is in the best interest of a minor child* is presumed where both parents agree to an award of joint custody.[205] An ordinary presumption.

7. *That child support should be ordered in accord with the guidelines of this statute* is presumed.[206] A strong presumption requiring a finding under section 43-19-103 of the Mississippi Code to rebut.

Domestic Abuse

1. *That a domestic abuse protective order from another state is valid* is presumed if the order appears authentic on its face.[207] A strong presumption with affirmative defenses available to rebut.

2. *That health care providers and others (listed) acted in good faith in making a report of suspected domestic abuse* is presumed.[208] An ordinary presumption.

Domicile

1. See **Divorce**.

2. *That his residence with his family is a man's domicile* is

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[202] Yancy v. Yancy, 752 So. 2d 1006, 1011 (Miss. 1999).
[203] MISS. CODE ANN. § 93-5-1 (1994).
[204] Parkinson v. Mills, 159 So. 651, 656 (Miss. 1935).
[205] MISS. CODE ANN. § 93-5-24(4) (2000).
[206] *Id.* § 43-19-101.
[207] *Id.* § 93-21-16.
[208] *Id.* § 93-21-23 (1994 & Supp. 2000).

presumed.[209] An ordinary presumption.

Easements

1. See **Adverse Possession**.

2. *That an easement was abandoned* is presumed from protracted non-use of it, and the presumption becomes stronger if the intent to abandon is shown.[210] An ordinary presumption.

3. *That an easement was abandoned* is presumed when the owner allows acts of others inconsistent with his or her enjoyment of the easement.[211] An ordinary presumption.

4. *That an easement was acquired by adverse possession* is presumed from adverse continuous use for the period of limitations.[212] Apparently a conclusive presumption.

5. *That an easement was acquired by adverse possession* is presumed from over fifty years of use.[213] Apparently a conclusive presumption which decides the case.

6. *That a road easement would stay open* is presumed from the sale of outer land providing the only access to inner land.[214] Apparently a conclusive presumption which decides the case.

Comment: The above so-called presumptions seem not to be real presumptions but an alternative way of expressing the legal conclusion when certain facts were found to exist, i.e., that ten years of adverse possession was shown in those cases and that the intent to abandon or provide the easement was proven in those cases.

7. *That there was a grant of easement* is presumed from long use even without proof of a grant or a deed.[215] A conclusive presumption which decides the case.

Comment: This is the presumption of a grant which is an

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[209] Johnson v. Johnson, 191 So. 2d 840, 842 (Miss. 1966).

[210] Bivens v. Mobby, 724 So. 2d 458, 461 (Miss. Ct. App. 1998).

[211] Columbus & Greenville Ry. Co. v. Dunn, 185 So. 2d 583, 585 (Miss. 1939).

[212] Jenkins v. McQuaid, 120 So. 2d 814, 816 (Miss. 1929).

[213] McCain v. Turnage, 117 So. 2d 454, 454-55 (Miss. 1960).

[214] Quin v. Sabine, 183 So. 2d 701, 701 (Miss. 1938).

[215] Gulf Mobile & Ohio R.R. Co. v. Tallahatchie Drainage Dist., 67 So. 2d 528, 533 (Miss. 1953).

alternative to an adverse possession claim based on the statute of limitations. See **Adverse Possession**.

Elections

1. *That marks other than the legal marks on a ballot were innocently made* is presumed.[216] An ordinary presumption.

2. *That election returns were valid and proper* is presumed unless there is proof of fraud.[217] A very strong presumption if fraud must be shown by clear and convincing evidence as is usual.

3. *That a vote was legal* is presumed.[218] An ordinary presumption.

4. See **Appellate Rules**.

Comment: These appear to be like the many presumptions favoring the acts of officials and placing the burden on a party challenging those acts to prove illegality or invalidity.

Electricity

1. See **Negligence** for application of *res ipsa loquitur* to accidents involving electricity.

Electric Power Associations

1. *That a majority of users in the area of a proposed electric power association have signified in writing that they will use electricity from that association* is *prima facie* proven by a certified copy of a statement under oath to that effect filed with the Mississippi Rural Electrification Authority.[219] An ordinary presumption.

Eminent Domain

1. *That a landowner is entitled to the amount of the first award* is presumed.[220] A conclusive presumption.

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[216] Tonnar v. Wade, 121 So. 2d 156, 160 (Miss. 1929).

[217] Lopez v. Holleman, 69 So. 2d 903, 910 (Miss. 1954).

[218] Hubbard v. McKey, 193 So. 2d 129, 132 (Miss. 1966).

[219] MISS. CODE ANN. § 77-5-511 (2000).

[220] Pearl River Valley Water Supply Dist. v. Brown, 184 So. 2d 407, 408 (Miss. 1966).

Comment: This is really not understood. It came up in context of a dispute over the costs of appealing a condemnation award and is stated as rationale for not taxing costs to the landowner because it would diminish his award and deny just compensation. The decision does not distinguish the first award from any other award.

Employer-Employee (Vicarious Liability)

1. *That the driver was an employee, within the scope of employment, and that the employer owned the truck* is presumed from proof of the employer's name on a commercial truck.[221] A strong presumption requiring clear and convincing evidence to rebut.

2. *That a driver was within the scope of employment* is presumed from proof that an employee was driving the employer's vehicle.[222] Apparently a strong presumption requiring that the employer prove the employee was on a mission of his own.

3. *That a chauffeur was within the scope of employment in allowing the employer's son to drive the car* is presumed from proof that the chauffeur was in charge of the employer's car.[223] An ordinary presumption.

4. *That an employee was within the scope of employment* is presumed from proof of the master-servant relationship.[224] An ordinary presumption.

5. *That the employee was within the scope of employment* is presumed from the employer's ownership of the truck driven by the employee.[225] An ordinary presumption.

Comment: These presumptions all seem to be supported by the logical connection of the presumed fact to the proven facts. An employee is usually on the job when driving the employer's vehicle. They may also be seen to fairly place the burden of rebutting the presumptions on the employer

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[221] Newell v. Harold Shaffer Leasing Co., Inc. 489 F.2d 103, 109 (5th Cir. 1974).

[222] Broadway v. Kelley Bros. Contractors, Inc., No. 1998-CT-01195-SCT, 2000 WL 730812, R *3-3 (Miss. June 8, 2000).

[223] Slaughter v. Holsomback, 147 So. 2d 318, 321 (Miss. 1933).

[224] Lovett Motor Co. v. Walley, 64 So. 2d 370, 372 (Miss. 1953).

[225] Bourgeois v. Miss. Sch. Supply, 155 So. 2d 209, 211 (Miss. 1934).

who usually has better access to and control of the evidence on the issue.

Employment

1. *That the results of alcohol or drug tests of employees are correct* is presumed where an employee is terminated for failing such tests.[226] An ordinary presumption.

Executors and Administrators

1. *That an executor, administrator or guardian has misappropriated money or property* is *prima facie* shown by the default of said executor, administrator or guardian in failing to file and settle his accounts as required by law.[227] An ordinary presumption.

Fair Trade

1. *That purchases and additions to stock within sixty days of the sale were made in contemplation of a going-out-of-business sale* is presumed.[228] An ordinary presumption.

2. See **Restraint of Trade**.

Farmers' Co-ops

1. *That products produced by anyone on the land of a co-op member during the term of the member's marketing contract with the co-op are the products of the member and subject to the marketing contract* is presumed when the member entered into the arrangement with the one producing the crops after the marketing contract.[229] A conclusive presumption.

Fraud

1. *That there was no bad motive, dishonesty or fraud (a party did not commit fraud)* is presumed.[230] A very strong presumption requiring clear and convincing evidence to rebut.

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[226] MISS. CODE ANN. § 71-7-25 (2000).
[227] *Id.* § 91-7-313 (1994).
[228] *Id.* § 75-65-5 (2000).
[229] *Id.* § 79-19-33(3) (1996 & Supp. 2000).
[230] Thompson v. Shell W. E. & P. Co., 607 So. 2d 37, 42 (Miss. 1992).

Gifts

1. *That a donee exercised undue influence in procuring a gift* is presumed when the donee was in a fiduciary relationship with the donor even though no suspicious circumstances are shown.[231] A very strong presumption requiring clear and convincing evidence to rebut.

2. See **Deeds**.

3. *That a conveyance was a gift* is presumed where there is a close relationship between the donor and the donee (e.g., husband and wife).[232] An ordinary presumption.

Grand Juries

1. *That a grand jury is competent and qualified* is conclusively shown by the empaneling of the grand jury, but the array may be challenged for fraud.[233] Thought to be a very strong presumption because fraud requires clear and convincing proof.

Guardians

1. *That a guardian of a non-resident appointed in another state or country was validly and lawfully appointed and is qualified* is presumed from proof of certified letters of guardianship and the certificate of the officer to whom such guardian is liable to account.[234] A conclusive presumption.

Husband and Wife

1. *That the wife was to have an equal interest in property* is presumed when the husband had the property conveyed to both.[235] An ordinary presumption.

2. *That property was a gift* is presumed of a conveyance from a husband to a wife.[236] An ordinary presumption.

3. *That a husband and wife live together* is presumed ab-

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[231] Griffin v. Armana, 687 So. 2d 1188, 1196 (Miss. 1996).

[232] Sunflower Farms, Inc. v. McClean, 117 So. 2d 808, 813 (Miss. 1960).

[233] MISS. CODE ANN. § 13-5-43 (1972 & Supp. 2000).

[234] *Id.* § 93-13-183 (1994).

[235] Miller v. Miller, 298 So. 2d 704, 706 (Miss. 1974), *abrogated on other grounds by* Pearson v. Pearson, 761 So. 2d 157 (Miss. 2000).

[236] *Sunflower Farms*, 117 So. 2d at 813-14.

sent contrary evidence.[237] An ordinary presumption.

4. *That the defendant acted with malice* is presumed from his adulterous relations with the plaintiff's wife in an action for interference with marital relations.[238] An ordinary presumption.

Illegitimate Children

1. See **Children** and **Bastardy**.

Insurance

1. *That a disability of six months duration is permanent* is presumed in construing a disability policy.[239] A conclusive presumption.

2. *That death was caused by violent external means and was not by suicide* is presumed in an action for accidental death policy proceeds.[240] A strong presumption placing the burden of persuasion that death was by suicide on the company.

3. *That it was intended that uninsured motorist coverage would be aggregated* is presumed where separate premiums were paid for multiple vehicles.[241] Probably a conclusive presumption which decides the case.

4. *That an applicant for insurance truthfully stated his age* is presumed absent contrary proof.[242] An ordinary presumption.

Intent

1. *That a person intends to do what he does* is presumed.[243] An ordinary presumption.

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[237] Fed. Reserve Bank v. Wall, 103 So. 5, 6 (Miss. 1924).

[238] Walter v. Wilson, 228 So. 2d 597, 598 (Miss. 1969).

[239] Heralds of Liberty v. Jones, 107 So. 519, 520 (Miss. 1926).

[240] Goodman v. Highlands Ins. Co., 607 F.2d 665, 667 (5th Cir. 1979).

[241] Harrison v. Allstate Ins. Co., 662 So. 2d 1092, 1094 (Miss. 1995).

[242] Interstate Life & Accident Ins. Co. v. Smith, 260 So. 2d 453, 457 (Miss. 1972).

[243] Bates v. Brevard-Woods Stave Co., 76 So. 553, 553 (Miss. 1917).

Internal Revenue Service

1. *That the IRS accurately determined the amount of tax owed* is presumed.[244] An ordinary presumption.

Joint Tenants

1. *That joint tenants each own a half interest in property* is presumed.[245] An ordinary presumption.

2. *That it was intended that title to a bank deposit in the names of two or more persons would vest in the survivor(s)* is presumed.[246] An ordinary presumption.

3. *That it was intended by all parties that title to a savings association deposit in the names of two or more persons would vest in the survivor(s)* is presumed.[247] A conclusive presumption.

Judges

1. *That a judge is qualified and impartial* is presumed.[248] A very strong presumption requiring rebuttal beyond a reasonable doubt.

Knowledge of the Law

1. *That every person knows the law and people must abide by the legal consequences of their acts* is presumed.[249] A very strong presumption requiring proof of misrepresentation or illegal concealment of facts.

Lawful Acts

1. *That people act lawfully and honestly* is presumed.[250] An ordinary presumption.

2. *That the course of business affairs is regular and valid* is

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[244] Mallete Bros. Constr. Co. v. United States, 695 F.2d 145, 148 (5th Cir. 1983).

[245] Leininger v. Leininger, 705 F.2d 727, 732 (5th Cir. 1983).

[246] MISS. CODE ANN. § 81-5-63 (1996 & Supp. 2000).

[247] *Id.* § 81-12-137(1).

[248] Upton v. McKenzie, 761 So. 2d 167, 172 (Miss. 2000).

[249] Quinn v. Miss. State Univ., 720 So. 2d 843, 850 (Miss. 1998).

[250] Foster v. Wright, 127 So. 2d 873, 875 (Miss. 1961); Miss. Power Co. v. Sellers, 133 So. 594 (Miss. 1931).

presumed.[251] An ordinary presumption.

Libel and Slander

1. *That a plaintiff is of good character* is presumed.[252] An ordinary presumption.

2. *That a defendant acted in good faith* is presumed where the defendant had a qualified privilege to publish the information.[253] Probably a strong presumption requiring plaintiff to prove the defendant acted in bad faith.

Mail (Receipt)

1. *That mail was received by the addressee* is presumed where the mail was properly addressed, postage was paid and it was placed with the United States Postal Service.[254] An ordinary presumption.

2. *That a bird dealer received an order and notice of the right to a hearing from the Commissioner of Agriculture* is presumed when mailed by certified mail with return receipt requested to the address last provided by such person to the Commissioner.[255] A conclusive presumption.

3. *That notice of cancellation of insurance was received* is presumed from a certificate of mailing showing the correct address and stamped by the postal service.[256] An ordinary presumption rebuttable by "significant and probative" evidence of non-receipt, a mere denial of receipt being insufficient to rebut.

Marriage

1. *That a ceremonial marriage was valid* is presumed.[257] A very strong presumption.

2. *That a subsequent marriage is valid and that prior mar-*

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[251] Melchor v. Casey, 161 So. 692, 694 (Miss. 1935).

[252] New Orleans Great N. R.R. Co. v. Frazer, 130 So. 493, 496 (Miss. 1930).

[253] Arnold v. Quillian, 262 So. 2d 414, 415 (Miss. 1972).

[254] Thames v. Smith Ins. Agency, Inc., 710 So. 2d 1213, 1216 (Miss. 1998).

[255] MISS. CODE ANN. § 75-40-115(2) (2000).

[256] Branch v. State Farm Fire & Cas. Co., 759 So. 2d 430, 433-44 (Miss. Ct. App. 2000).

[257] Whitman v. Whitman, 41 So. 2d 22, 24-25 (Miss. 1949).

riage was dissolved by divorce or death is presumed.[258] A very strong presumption requiring clear and convincing evidence to rebut.

Comment: These presumptions have been said to be among the strongest presumptions and are based on public policy favoring the validity of marriage, the legitimacy of children, inheritance of property and the moral standards of the community.[259]

3. *That a subsequent marriage is valid* is presumed and is superior to the presumption of the continuation of life.[260] A very strong presumption.

4. *That the parties had capacity and gave consent and all other essentials to a valid marriage* is presumed from a showing of a ceremonial marriage.[261] A strong presumption.

5. *That a foreign marriage is valid* is presumed.[262] A strong presumption.

6. *That an adulterous relationship continued* is presumed until there is clear proof of a common law marriage where the parties had begun an adulterous relationship.[263] A strong presumption.

7. *That the parties were married* is presumed when they lived together with their children and were so regarded by relatives.[264] Likely a very strong presumption.

8. *That an illicit relationship between a man and a woman continued after the death of the man's first wife* is presumed from their having entered into such relationship before her death.[265] An ordinary presumption.

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[258] *In re* Erwin's Estate, 317 So. 2d 55, 57 (Miss. 1975); Carr v. Carr, 724 So. 2d 937, 941 (Miss. Ct. App. 1998).

[259] Matthews v. Jones, 149 F.2d 893, 894 (5th Cir. 1945); Jeffreys v. Clark, 168 So. 2d 662, 671 (Miss. 1964).

[260] *Jeffreys*, 168 So. 2d at 671.

[261] Smith v. Weir, 387 So. 2d 761, 763 (Miss. 1980).

[262] Walker v. Matthews, 3 So. 2d 820, 823-24 (Miss. 1941).

[263] Green v. Ribicoff, 201 F. Supp. 721, 723 (S.D. Miss. 1961).

[264] Stevenson's Heirs v. McReary, 20 Miss. 9, 11 (1849).

[265] Thompson v. Clay, 82 So. 1, 2 (Miss. 1919).

Master and Servant

1. See **Employer and Employee**.

Medical Expenses

1. *That medical bills of hospitals and doctors were reasonable and necessary* is *prima facie* shown by evidence that the bills were incurred and paid.[266] An ordinary presumption.

Minors

1. *That married minors occupy or intend to occupy property as a place of residence* is presumed from execution of documents pertaining to their actual residence.[267] A conclusive presumption said to assure validity and enforceability of such documents.

Missing Persons

1. *That a person is missing, missing in action, interned in a neutral country or beleaguered, besieged or captured by an enemy, or is dead, or is alive* is *prima facie* shown by an official written report or record, or duly certified copy thereof stating such facts, made by an officer or employee of the United States authorized to make such record or report.[268] An ordinary presumption.

2. *That the report or record referred to in section 13-1-25(2) of the Mississippi Code is authentic and that the officer or employee was authorized to make the finding* is *prima facie* shown by a certified copy of such a report or record.[269] An ordinary presumption.

Mortgages

1. *That an instrument was a deed and not a mortgage* is presumed where the grantee took possession under the instrument.[270] An ordinary presumption.

2. *That an instrument is in legal effect a deed, as it pur-*

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[266] MISS. CODE ANN. § 41-9-119 (1993 & Supp. 2000).
[267] *Id.* § 93-3-11 (1994).
[268] *Id.* § 13-1-25(2) (1972 & Supp. 2000).
[269] *Id.* § 13-1-25(3).
[270] Bethea v. Mullins, 85 So. 2d 452. 456 (Miss. 1956).

ports to be, and not a mortgage is presumed.[271] An ordinary presumption.

3. *That valuable consideration was given and there was no fraud in procuring a trust deed* is presumed.[272] A very strong presumption if clear and convincing evidence is required to prove fraud, as is usual.

4. *That a deed of trust was security for a debt* is presumed when the grantor claimed that payment was made.[273] An ordinary presumption.

Negligence

1. *That the owner of a team of horses was negligent* is presumed when the team ran away without a driver.[274] An ordinary presumption.

2. *That the city was on notice of a defect in a sidewalk* is presumed when the defect had existed for years.[275] An ordinary presumption.

3. *That a child between the age of seven and fourteen cannot be contributorily negligent* is presumed.[276] A strong presumption requiring the opposing party to persuade of exceptional abilities/capacities.

4. *That a child below the age of seven cannot be contributorily negligent* is presumed.[277] A conclusive presumption.

Comment: No cases are found dealing with the primary negligence of children as defendants. Presumably the same standards as with contributory negligence would apply, based on the Rule of Sevens.

5. *That a deceased exercised ordinary care for his own safety* is presumed.[278] A strong presumption.

Comment: This is but another way of expressing that the

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[271] Jones v. Jones, 84 So. 2d 414, 420 (Miss. 1956).

[272] Thoms v. B. Rosenberg & Sons, 120 So. 732, 733 (Miss. 1929).

[273] Schumpert v. Dillard, Pinson & Co., 55 Miss. 348, 363-64 (1877).

[274] Willis v. Semmes, 71 So. 865, 865-66 (Miss. 1916).

[275] Jones v. City of Columbus, 134 F.2d 464, 465 (5th Cir. 1943).

[276] Steele v. Holiday Inns, Inc., 626 So. 2d 593, 601 (Miss. 1993); Glorioso v. Y.M.C.A., 556 So. 2d 293, 295 (Miss. 1989).

[277] Pascagoula St. Ry. & Power Co. v. Brondum, 50 So. 97, 104 (Miss. 1909).

[278] S.H. Kress & Co. v. Markline, 77 So. 858, 864 (Miss. 1918).

defendant has the burden of proof on comparative negligence.

6. *That a person saw what was there to be seen* is presumed.[279] Probably a conclusive presumption which imposes the tort duty on the person to exercise ordinary care in light of that which was visible, whether he or she saw anything or not.

7. *That the defendant was negligent in causing plaintiff's injuries* is presumed from proof that the defendant controlled the instrumentality which caused injury, the accident is such that would ordinarily not occur without negligence and the plaintiff did not voluntarily contribute in causing the accident.[280] An ordinary presumption.

Comment: Res Ipsa Loquitur. The court has referred to this as raising an inference which the jury may or may not draw and also as a presumption which puts the burden on the defendant to present evidence of no negligence. The jury is to be instructed of the effect of their finding the underlying facts but the burden of persuasion remains on the plaintiff.

8. *That a vending machine would not fall on a patron without negligence* is presumed.[281] An ordinary presumption.

9. *That injury or damages were caused by negligence of the defendant* is *prima facie* shown by proof that the defendant was running, operating or causing a motor vehicle to be run or operated in a manner contrary to chapters 3 and 5 of title 63 of the Mississippi Code.[282] A strong presumption requiring the party to prove that although violating the statute, he or she was exercising ordinary care.

Comment: This is a statutory negligence *per se* rule. Chapter 3 of title 63 has Traffic Regulations and Rules of the Road. Chapter 5 has regulations on size, weight, and load.

10. See **Automobiles, Collisions, Carriers** and **Shipping**.

11. *That livestock on a federal or state highway were the*

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[279] Splain v. Hines, 609 So. 2d 1234, 1241 (Miss. 1992).

[280] Read v. S. Pine Elec. Power Ass'n, 515 So. 2d 916, 919-20 (Miss. 1987).

[281] Fisher v. Daniels, 173 So. 2d 908, 915 (Miss. 1965).

[282] MISS. CODE ANN. § 13-1-123 (1972 & Supp. 2000).

cause of wrecks, loss of life or bodily injury is presumed. Section 68-13-111 of the Mississippi Code places the burden on the owner of livestock to prove no negligence and no causation. The presumption of negligence and causation vanishes, and a verdict may be directed for defendant when plaintiff offers no evidence against defendant's strong case of no negligence.[283] An ordinary presumption.

Comment: This indicates the presumption retained no weight after the rebuttal, at least when the defendant's evidence of no negligence was compelling.

Officials

1. *That a person is an official of any state or the United States* is *prima facie* shown by any certificate, attestation or authentication purporting to have been made or given by that person in that position.[284] An ordinary presumption.

Paint, Etc.

1. *That a paint, putty, linseed oil or other paint oils, turpentine, or varnish is misbranded or insufficiently branded or labeled or adulterated* is *prima facie* shown by a sworn certificate from the state chemist stating such facts and sent to the proper district attorney.[285] An ordinary presumption.

Parent and Child

1. *That it is in the best interest of a child to be in the custody of a natural parent* is presumed.[286] A very strong presumption requiring clear and convincing evidence to rebut.

2. See also **Children**.

Partnerships

1. *That partners were intended to share profits equally* is presumed.[287] An ordinary presumption.

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[283] Harris v. Penn, 2001 WL 19723, *6 (Miss. Ct. App. 1999).
[284] MISS. CODE ANN. § 13-1-81 (1972 & Supp. 2000).
[285] *Id.* § 75-53-15 (2000).
[286] SCR v. FWK & LSK, 748 So. 2d 693, 700 (Miss. 1999).
[287] Foster v. Wright, 127 So. 2d 873, 878 (Miss. 1961).

2. *That a business association is a partnership* is presumed where the associated people shared profits.[288] An ordinary presumption.

3. *That a partnership continued to exist* is presumed where a partnership is shown to have begun.[289] An ordinary presumption.

4. *That a debt of a partnership was paid* is presumed where a partner paid the debt.[290] An ordinary presumption.

5. *That a limited partnership was formed and exists* is conclusively shown as to its formation and *prima facie* shown as to its existence by a certificate of limited partnership certified by the Secretary of State.[291] A conclusive presumption as to formation and an ordinary presumption as to its continued existence.

6. *That a partnership for a fixed term continued* is *prima facie* shown by continuation of the business by the partners or such of them as habitually acted therein during the term.[292] An ordinary presumption.

Patents

1. *That a patent is valid* is presumed.[293] A very strong presumption requiring clear and convincing evidence to rebut.

Payment

1. *That a debt was paid* is presumed when an attachment was levied on the property of the debtor.[294] An ordinary presumption.

2. *That a debt was paid* is presumed after sixteen years from when it was incurred.[295] An ordinary presumption.

3. *That a debt was paid* is presumed after the debtor was in possession of land securing the debt for a long time.[296] An

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[288] *Foster*, 127 So. 2d at 877-78.
[289] *In re* Hammons, 614 F.2d 399, 403 (5th Cir. 1977).
[290] Mayson's Adm'r v. Beazley's Adm'r, 27 Miss. 106, 111-12 (1854).
[291] MISS. CODE ANN. § 79-14-201 (2000).
[292] *Id.* § 79-12-45(2) (1996).
[293] Antici v. KBH Corp., 324 F. Supp. 236, 242 (N.D. Miss. 1971).
[294] Benson v. Benson, 24 Miss. 625, 629 (1852).
[295] Didlake v. Robb, 7 F. Cas. 680, 681 (C.C.N.D. Miss. 1874) (No. 3,899).
[296] Rosenbaum v. Bohannon, 36 So. 2d 798, 799 (Miss. 1948) (stating forty-four

ordinary presumption.

4. *That a debt was paid* is presumed after the running of the statute of limitations on the debt, but provides no defense against a foreclosure action.[297] Likely a conclusive presumption.

5. *That a check was taken as a conditional and not an absolute payment* of an existing debt is presumed.[298] An ordinary presumption.

Process

1. *That a constable who served process was authorized to do so* is presumed.[299] An ordinary presumption.

2. *That the correct person was served process* is presumed although the designation of that person as junior was omitted on the return.[300] An ordinary presumption.

Public Lands

1. *That a government patent for land was legal and the patent valid* is presumed.[301] An ordinary presumption.

2. *That the patentee entered land under his patent and the law* is presumed.[302] An ordinary presumption.

3. *That title to land is legal* is presumed from the patent and possession.[303] An ordinary presumption.

4. *That leases, or extensions, renewals or replacement of leases of sixteenth section lands* are *prima facie* valid but may be challenged for inadequate consideration.[304] An ordinary presumption.

5. *That the state patented land* is presumed when more than twenty-five years have passed since it was sold for taxes,

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years of possession is sufficient); Stark v. Gildart, 6 Miss. 606, 620 (1841) (stating twenty years of possession is sufficient).

[297] Wilkinson v. Flowers, 37 Miss. 579, 585 (1859).

[298] Citizens' Bank v. Kretschmar, 44 So. 930, 932 (Miss. 1907).

[299] Pointer v. Huffman, 509 So. 2d 870, 873 (Miss. 1987).

[300] Sanders v. Dowell, 15 Miss. 206, 212 (1846).

[301] Surget v. Little, 24 Miss. 118, 122 (1852).

[302] Carter v. Blanton, 33 Miss. 291, 292 (1857).

[303] Jenkink v. Trager, 40 F. 726, 728 (S.D. Miss. 1889).

[304] MISS. CODE ANN. § 29-3-52 (2000).

there is no record of a patent and the applicant paid taxes for the past ten years.[305] Probably a conclusive presumption.

6. *That a patent from the state, for land forfeited for taxes, is valid* is presumed where the patent is more than ten years old and taxes since have been paid.[306] Probably a conclusive presumption.

Public Nuisance

1. *That a public nuisance exists and the person charged with such nuisance had knowledge of its existence and acquiescence and participation therein* is *prima facie* proved by evidence of the general reputation of the place or an admission or finding of guilt of any person under the criminal laws against prostitution, lewdness or assignation at such place.[307] An ordinary presumption.

2. *That owners of personal property seized or real property affected by an order abating a public nuisance had knowledge of the general reputation of the place* is presumed.[308] An ordinary presumption.

3. *That a person is the owner of real estate affected by a public nuisance action* is presumed from the name of that person standing as owner on the books of the tax collector for purposes of taxation.[309] An ordinary presumption.

Public Records

1. *That lost records and levies of taxes or other public legislative matter of boards of supervisors were correctly re-established* is conclusively presumed where the board of supervisors re-established those lost records except that as to rights accrued before the re-establishment of the records which are *prima facie* correct.[310] Conclusive that the records were correctly re-established but an ordinary presumption as to accrued rights.

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[305] *Id.* § 29-1-113.
[306] *Id.* § 29-1-115.
[307] *Id.* § 95-3-13 (1994).
[308] *Id.* § 95-3-15.
[309] *Id.* § 95-3-17.
[310] *Id.* § 25-55-17 (1999).

Railroads

1. See **Carriers**.

Restraint of Trade

1. *That a dealer in cigarettes intended to injure competitors and to destroy or substantially lessen competition* is *prima facie* proven by evidence of advertising or selling cigarettes at less than cost, an offer or giving of rebates, offer or giving of a concession connected to the sales of cigarettes, or inducing or attempting to induce or procure the purchase of cigarettes at less than cost.[311] An ordinary presumption.

2. *That the cost of cigarettes is the lowest cost to wholesalers or retailers determined by a cost survey in the same trading area* is presumed absent proof of actual costs in determining whether a wholesaler or retailer was in good faith selling at a price to meet competition.[312] An ordinary presumption.

3. *That a chain of cotton gin operators is discriminating in prices* is *prima facie* shown by evidence of lower charges for ginning services or higher prices being paid for cotton seed in one locality than another.[313] An ordinary presumption.

4. *That a combine in restraint of freedom of trade or production existed* is *prima facie* shown by evidence of a lower charge for a service or of paying higher prices for commodities in one locality than another, differences of freight and other necessary expenses considered.[314] An ordinary presumption.

Resulting Trusts

1. *That a resulting trust existed* is presumed where the grantor does not intend the person taking title to property to have the beneficial interest.[315] Likely a conclusive presumption which decides the case.

2. *That a resulting trust arose* is presumed where a hus-

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[311] *Id.* § 75-23-7(b) (2000).
[312] *Id.* § 75-23-15(b).
[313] *Id.* § 75-41-11.
[314] *Id.* § 75-21-3.
[315] Bird v. Stein, 258 F.2d 168, 176 (5th Cir. 1958).

band buys property with his wife's money.[316] A strong presumption.

3. *That the titleholder intended to hold property in trust for another* is presumed when the titleholder is obligated in equity to hold title for the benefit of others.[317] Likely a strong presumption.

4. *That a resulting trust arose in favor of the one who paid for property* is presumed when one person pays for property and another takes title.[318] A strong presumption.

Schools

1. *That school board members, as adjudicators in a teacher termination hearing, acted with honesty and integrity* is presumed.[319] A strong presumption.

2. *That there was discrimination in a school system* is presumed where the system has a history of segregation and a disproportionate racial makeup.[320] An ordinary presumption.

3. *That removing territory from a school district would impair its efficiency* is presumed.[321] A strong presumption.

4. *That teachers and a principal who held posts before dismantling of a dual system remained qualified* is presumed.[322] A strong presumption.

Sanity

1. *That people are competent and sane* is presumed.[323] An ordinary presumption.

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[316] Ford v. Am. Home Fire Ins. Co., 5 So. 2d 416, 417 (Miss. 1942).

[317] Church of God Pentecostal, Inc. v. Freewill Pentecostal Church of God, Inc. 716 So. 2d 200, 207 (Miss. 1998).

[318] Stevens v. Hill, 236 So. 2d 430, 432-33 (Miss. 1970).

[319] Harris v. Canton Separate Pub. Bd. of Educ., 655 So. 2d 898, 903 (Miss. 1995).

[320] Thompson v. Madison County Bd. of Educ., 496 F.2d 682, 687 (5th Cir. 1974).

[321] Belden Consol. Sch. Dist. v. Lee, 133 So. 225, 227 (Miss. 1931).

[322] Cousin v. Bd. of Trs. of the Houston Mun. Separate Sch. Dist., 648 F.2d 293, 298 (5th Cir. 1981).

[323] Carter v. Miss. Bar Ass'n, 654 So. 2d 505, 513 (Miss. 1995).

Savings Associations

1. See **Joint Tenants**.

Shipping

1. See **Collisions** and **Carriers**.

Spoliation of Evidence

1. *That evidence would be unfavorable to a party* is inferred from damage or destruction of the evidence in bad faith by that party, so it is not available at trial.[324] An inference which warrants an instruction.

2. *That the plaintiff was exposed to the disease (AIDS) carrying agent, and that exposure caused emotional distress,* is presumed from proof that the defendant destroyed the best evidence (possibly contaminated syringe) from which that exposure could be determined, with knowledge of the need for that evidence.[325] Probably an ordinary presumption but likely determinative of causation because the defendant cannot rebut it without the evidence.

Suicide

1. *That a person loves life, will avoid danger and will not commit suicide* is presumed.[326] An ordinary presumption.

2. No presumption against suicide when person is shown to have been insane.[327]

3. See **Insurance**.

Taxation (Ad Valorem)

1. *That the book value of corporate assets is the correct basis for taxation* is presumed.[328] An ordinary presumption.[329]

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[324] DeLaughter v. Lawrence County Hosp., 601 So. 2d 818, 821-22 (Miss. 1992).

[325] S. Cent. Reg'l Med. Ctr. v. Pickering, 749 So. 2d 95, 102 (Miss. 1999).

[326] State *ex rel.* Richardson v. Edgeworth, 214 So. 2d 579, 585 (Miss. 1968).

[327] *Richardson*, 214 So. 2d at 585.

[328] Miss. State Tax Comm'n v. Ill. Cent. Gulf R.R., 360 So. 2d 1218, 1221-22 (Miss. 1978).

[329] *Mississippi State Tax Comm'n*, 360 So. 2d at 1221-22.

Tenancy in Common

1. *That the acts of a cotenant in possession (paying taxes or redeeming property from tax sale) are for the benefit of the other cotenants* is presumed.[330] A very strong presumption.

2. *That the possession of one cotenant is not hostile to other cotenants* is presumed.[331] A very strong presumption.

Comment: These presumptions appear to be in support of the law that, because they are in fiduciary relations, a cotenant must affirmatively oust other cotenants in order to establish title by adverse possession.[332] They are placed in the very strong category because the cotenant in possession must prove ouster by clear and convincing evidence in order to prevail.[333]

3. *That conveyances to two or more persons, including to a husband and wife, created a tenancy in common* is to be construed from a conveyance.[334] An ordinary presumption rebuttable by the tenor of the instrument indicating that it was intended to create a joint tenancy or tenancy by the entireties.

Timber (Unlawful Cutting)

1. *That a defendant is liable for unlawfully cutting or taking trees* is *prima facie* shown by evidence that the timber belonged to the owner and the defendant or his employees cut down, deadened, destroyed or took away the timber without the owner's consent.[335] A conclusive presumption.

2. *That a defendant is liable, in addition to those listed in section 95-5-10(1) of the Mississippi Code, for the penalties for unlawfully cutting or taking trees* is *prima facie* shown by evidence that the defendant or his employees willfully and knowingly, in conscious disregard for the rights of the owner, cut down, deadened, destroyed or took away such trees.[336] A conclusive presumption.

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[330] Bayless v. Alexander, 245 So. 2d 17, 20 (Miss. 1971).
[331] Hurst v. J.M. Griffin & Sons, 46 So. 2d 440, 442 (Miss. 1950).
[332] Fox v. Wilkins, 28 So. 2d 577, 579 (Miss. 1947).
[333] Jordon v. Warren, 602 So. 2d 809, 815 (Miss. 1992).
[334] MISS. CODE ANN. § 89-1-7 (2000).
[335] *Id.* § 95-5-10(1).
[336] *Id.* § 95-5-10(2).

Title Claims

1. See **Vendor** and **Purchaser**.

Undue Influence

1. See **Contracts, Deeds, Gifts** and **Wills.**

Uniform Commercial Code

Comment: The UCC provides descriptions of the presumptions created in that code as follows:

"Burden of establishing" a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence.[337] This language creates a strong presumption.

"Presumption" or "presumed" means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its nonexistence.[338] This language creates an ordinary presumption.

1. *That documents required by a contract to be issued by a third party and the facts stated in such documents are authentic and genuine* is *prima facie* shown by the documents in due form.[339] An ordinary presumption.

2. *Establishing that a party with an option to accelerate payment or performance acted with a lack of good faith* is the burden of the party against whom the power was exercised.[340] A strong presumption of good faith.

3. *Establishing that a party with an option to accelerate payment or performance of a consumer lease acted in good faith* is the burden of the party who exercised the power.[341] A strong presumption of bad faith with consumer leases.

4. *Establishing that there was a breach with respect to accepted goods* is the burden of the buyer.[342] A strong pre-

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[337] *Id.* § 75-1-201(8).
[338] *Id.* § 75-1-201(31).
[339] *Id.* § 75-1-202.
[340] *Id.* § 75-1-208.
[341] *Id.* § 75-2A-109(2).
[342] *Id.* § 75-2-607(4).

sumption.

5. *Establishing that an incomplete instrument was completed without authority* is the burden of the party asserting that lack of authority.[343] A strong presumption.

6. *That a signature on a negotiable instrument is authentic and authorized* is presumed, unless the action is to enforce the liability of a purported signer and the signer is dead or incompetent at the time of trial.[344] An ordinary presumption.

7. *That a person signing a negotiable instrument is an accommodation party* is presumed.[345] An ordinary presumption.

8. *That the measure of liability for conversion of a negotiable instrument is the amount payable on the instrument* is presumed.[346] An ordinary presumption.

9. *That a negotiable instrument was dishonored and any notice stated was given* is presumed from different types of writings listed in the statute.[347] An ordinary presumption.

10. *That the signature on a certificated security is genuine or authorized* is presumed, but if the signature is put in issue the burden of establishing it is on the party claiming under it.[348] An ordinary presumption.

11. See **Bills and Notes**.

Vendor and Purchaser

1. *That a purchaser knew of defects in title from recitals in vendor's deed* is presumed.[349] Probably a conclusive presumption which denies the purchaser status of a bona fide purchaser (BFP) without notice.

2. *That a purchaser knew of the contents of a deed in his grantor's chain of title* is presumed.[350] Likely conclusive on purchaser's notice of a claim or defect.

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[343] *Id.* § 75-3-115(d).
[344] *Id.* § 75-3-308(a).
[345] *id.* § 75-3-419(c).
[346] *Id.* § 75-3-420(b).
[347] *Id.* § 75-3-505(a).
[348] *Id.* § 75-8-114(2).
[349] Chew v. Calvert, 1 Miss. 54, 62 (1818).
[350] Balwin v. Anderson, 60 So. 578, 580 (Miss. 1913).

3. *That a purchaser knows what is on the face of title documents* is presumed.[351] Said to be a conclusive presumption.

4. *That a purchaser was a BFP for value* is presumed from the recital of consideration in a quitclaim deed.[352] A strong presumption.

Weights and Measures

1. *That weights or measures are accurate* is *prima facie* shown by a weight certificate properly signed and sealed by a licensed and bonded weighmaster.[353] An ordinary presumption.

2. *That a gasoline pump, truck or other equipment is giving inaccurate measure* is *prima facie* presumed from any refusal to allow a representative of the Commissioner of Agriculture and Commerce to inspect the pump, truck or other equipment.[354] An ordinary presumption.

3. *That a weight or measure or weighing or measuring device is regularly used for commercial purposes by the person in charge of a building, enclosure, stand or vehicle* is presumed from proof of the existence of such measure or device in or about any building, enclosure, stand or vehicle in or from which buying and selling is commonly carried on.[355] A very strong presumption requiring conclusive proof to rebut.

Wills

1. *That a will was procured by the undue influence of the beneficiary* is presumed where the beneficiary was in a confidential relationship with the testator and there were suspicious circumstances in the making of the will.[356] A very strong presumption which requires rebuttal by clear and convincing evidence that the beneficiary acted in good faith and the testator acted with knowledge and by independent consent and ac-

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[351] Magee v. Holmes, 70 So. 2d 60, 64 (Miss. 1954).
[352] Robertson v. Dombroski, 678 So. 2d 637, 640 (Miss. 1996).
[353] MISS. CODE ANN. § 75-27-315(4) (2000).
[354] *Id.* § 75-55-37.
[355] *Id.* § 75-27-63.
[356] Estate of Smith, 722 So. 2d 606, 611-12 (Miss. 1998).

tion.[357]

2. *That a will is valid* is presumed from the passage of a great lapse of time under some circumstances.[358] An ordinary presumption.

3. *That a will was revoked* is presumed where the will was made by the testator, was in the hands of the testator and was not found after his death by a diligent search.[359] A very strong presumption which may be rebutted by clear and convincing evidence.[360]

4. *That the testator intended to revoke his will* is presumed where the testator canceled or destroyed one of the copies of the will.[361] An ordinary presumption which does not arise when circumstances show no revocation was intended.

5. *That a will is valid* is *prima facie* shown by it having been duly admitted to probate.[362] An ordinary presumption.[363]

Workers' Compensation

1. *That a wife and legitimate children under eighteen are dependent on the worker* is presumed.[364] A conclusive presumption.

2. *That a worker is not impaired* is presumed when the worker's post-injury earnings equal or exceed the pre-injury earnings.[365] An ordinary presumption.

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[357] Estate of Dabney, 740 So. 2d 915, 920-21 (Miss. 1999).
[358] Gathings v. Howard, 84 So. 240, 245 (Miss. 1920).
[359] Watkins v. Watkins, 106 So. 753, 757 (Miss. 1926).
[360] Estate of Cannon, 733 So. 2d 245, 248 (Miss. 1999).
[361] Phinizee v. Alexander, 49 So. 2d 250, 252 (Miss. 1951).
[362] MISS. CODE ANN. § 91-7-27 (2000).
[363] Perry v. Aldrich, 169 So. 2d 786, 789 (Miss. 1964).
[364] Watson v. Nat'l Burial Ass'n, 107 So. 2d 739, 742 (Miss. 1979).
[365] Winters v. Choctaw Maid Farms, Inc., 764 So. 2d 471 (Miss. Ct. App. 2000) (withdrawn from volume, *cert. pending*).

SECTION II
NON-EVIDENTIARY PRESUMPTIONS

Comment: These are not presumptions at all in the evidentiary sense. Rather, the court sometimes chooses to phrase, in terms of presumptions, rules which place the burdens of convincing a trial or appellate court that what is presumed is not true. These are found in many cases involving appeals from lower courts and from local or state agencies or officials challenging the acts of those officials or local and state governmental units or agencies. The rules uniformly favor the validity and legality of the actions challenged. The court also sometimes expresses rules in terms of presumptions in cases involving challenges to or interpretation of statutes and interpretation of contracts.

Ad Valorem Tax Sales and Proceedings

1. *That the bid amount was paid at a tax sale* is presumed when the tax deed was issued.[366]

2. *That land sold to the state was assessed and sold under valid existing law* is presumed.[367]

3. *That the tax assessor intended to act in the proper manner* is presumed.[368]

4. *That tax sales were legally made* is presumed from the tax collector's certification list of properties sold.[369]

5. *That the tax collector sold to the state as required by law* is presumed.[370]

6. *That the former owner paid taxes, costs and damages when he obtained a new patent after a tax sale* is presumed where the land remained assessed to the former owner after the tax sale and he continued to pay taxes without knowing of the tax sale of his land.[371]

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[366] Burroughs v. Vance, 23 So. 548, 548 (Miss. 1898).
[367] Mitchell v. Tubb, 65 So. 216, 217 (Miss. 1914).
[368] Belhaven Heights Co. v. May, 192 So. 6, 8 (Miss. 1939).
[369] Leavenworth v. Claughton, 19 So. 2d 815, 816 (Miss. 1944).
[370] State v. Wilkinson, 20 So. 2d 193, 196 (Miss 1944).
[371] State v. Butler, 21 So. 2d 650, 653 (Miss. 1945).

7. *That lands were legally sold for taxes* is presumed.[372]

8. *That the tax sale of land in one of two counties in which it was assessed was legal* is presumed.[373]

9. *That a tax deed correctly recites the facts* is presumed.[374]

10. *That tax assessments and sales are valid* is *prima facie* shown by tax collector's conveyance or list of properties sold to the state.[375]

11. *That city assessments were duly levied and assessment rolls duly made and adopted and all proceedings were duly had, taken and performed* is sufficiently shown by the assessment rolls and record thereof.[376]

12. *That the assessment of a lot for tax purposes included the value of an easement* is presumed.[377] An ordinary presumption.

Agency Jurisdiction

1. *That a person or other entity providing coverage in the state for medical, surgical, chiropractic, physical therapy, speech pathology, audiology, professional mental health, dental, hospital or optometric expenses is subject to the jurisdiction of the State Department of Insurance* is presumed; rebuttable by showing it is subject to the jurisdiction of another agency of the state or the federal government.[378]

Constitutional Law

1. Due process is denied when the state applies an irrebuttable presumption where the presumed fact does not necessarily follow from the proven facts.[379]

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[372] May v. Ellis, 210 So. 2d 883, 885 (Miss. 1968).

[373] Guess v. Riverside Farms, Inc., 340 So. 2d 6, 8 (Miss. 1976).

[374] Thibodeaux v. Havens, 77 So. 313, 314 (Miss. 1918).

[375] MISS. CODE ANN. § 13-1-115, *repealed by* 1991 Miss. Laws, ch. 573, § 141.

[376] MISS. CODE ANN. § 21-41-39 (2000).

[377] Hearn v. Autumn Woods Office Park Prop. Owners Ass'n, 757 So. 2d 155, 162 (Miss. 1999).

[378] MISS. CODE ANN. § 83-1-101 (2000).

[379] Andrews v. Drew Mun. Separate Sch. Dist., 507 F.2d 611, 614 (5th Cir. 1975).

Contract Interpretation and Construction

1. *That a contractor was to repair a bridge to its previous condition or to be reasonably safe* is presumed from a contract lacking specific terms.[380]

2. *That a contract will be interpreted to be legal* is presumed.[381]

3. *That a clear and unambiguous contract is the whole contract* is presumed.[382]

4. *That the place of performance of a contract is the place where the contract was made* is presumed.[383]

5. *That the parties impliedly agreed to what was reasonable* is presumed absent specific terms in the contract.[384]

Judgments (Validity)

1. *That all facts needed for the trial court to have had jurisdiction* is presumed unless the contrary appears in the record.[385]

2. *That a chancellor's support order is correct* is presumed.[386]

3. *That jurisdictional facts existed in a court of general jurisdiction* is presumed where there is a collateral attack on a judgment.[387]

4. *That a court in another state had jurisdiction and its judgment is valid* is presumed.[388]

5. *That the facts necessary for the validity of a foreign divorce exist* is presumed.[389]

6. *That proceedings at the trial court were valid* is pre-

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[380] Holmes v. T.M. Strider & Co., 189 So. 518, 521 (Miss. 1939).

[381] Merrill v. Melchior, 30 Miss. 516, 531 (1855).

[382] Cont'l Grain Co. v. Freeman, 237 F. Supp. 240, 244 (N.D. Miss. 1964).

[383] Hartford Accident & Indem. Co. v. Delta & Pine Land Co., 150 So. 205, 207 (Miss. 1933).

[384] Standard Millwork & Supply Co. v. Miss. Steel & Iron Co., 38 So. 2d 448, 450 (Miss. 1949).

[385] Dyer v. Russell, 38 So. 2d 104, 106-07 (Miss. 1948).

[386] Bredemeier v. Jackson, 689 So. 2d 770, 778 (Miss. 1997).

[387] Rowell v. Logan, 138 So. 2d 737, 739-40 (Miss. 1962).

[388] Custom Leasing, Inc. v. Gardner, 307 F. Supp. 161, 164 (N.D. Miss. 1969).

[389] Nichols v. Estate of Saul, 165 So. 2d 352, 355 (Miss. 1964).

sumed.[390] *That facts on which a judgment was based* were correct is presumed.[391]

7. *That findings of fact by a bankruptcy court were correct* is presumed unless shown clearly erroneous.[392]

8. *Prejudice from the denial of procedural due process* is presumed.[393]

Local Governments, Public Officials and Agencies

1. *That acts of local officials were valid and done according to law* is presumed.[394]

2. *That a Worker's Compensation Commission decision was correct and that it found facts to support the order* is presumed.[395]

3. *That the findings and order of the PSC were correct* is presumed.[396]

4. *That a determination of the Public Service Commission was right and proper* is *prima facie* shown by a certified record of a determination of the PSC.[397] Burden of proof shall be on the party seeking to vacate an order of the PSC.[398]

5. *That the ruling by the Tax Commission was correct* is presumed.[399]

6. *That an assessment of sales tax by the Tax Commission was correct* is presumed with the burden on the taxpayer to establish an exemption.[400]

7. *That municipal ordinances are valid and adopted ac-*

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[390] Gates v. Gates, 616 So. 2d 888, 890 (Miss. 1993).

[391] Viator v. Stone, 29 So. 2d 274, 277 (Miss. 1947).

[392] *In re* Hammons, 614 F.2d 399, 402-03 (5th Cir. 1977).

[393] Wisdom v. Stegall, 70 So. 2d 43, 46 (Miss. 1954).

[394] Parker v. Touliatos, 244 So. 2d 7, 8 (Miss. 1971) (Tax Collector); Bd. of Educ. v. Parents & Custodians, 168 So. 2d 814, 818 (Miss. 1964) (Board of Education); Caruthers v. Panola County, 38 So. 2d 902, 905 (Miss. 1949) (Board of Supervisors); W.T. Rawleigh Co. v. Hester, 200 So. 250, 253 (Miss. 1941) (Sheriff); Hamblen v. Hamblen, 33 Miss. 455, 461 (1857) (Sheriff's Sale).

[395] Yazoo Mfg. Co. v. Schaffer, 179 So. 2d 784, 791 (Miss. 1965).

[396] Arnold Line Water Ass'n. v. Miss. Pub. Serv. Comm'n, 744 So. 2d 246, 249 (Miss. 1999).

[397] MISS. CODE ANN. § 77-1-41 (2000).

[398] *Id.* § 77-3-77.

[399] Purcell Co. v. Miss. State Tax Comm'n, 569 So. 2d 297, 300 (Miss. 1990).

[400] Buelow v. Glidewell, 757 So. 2d 216, 220 (Miss. 2000).

cording to law is presumed.[401]

8. *That a public official did his lawful duty* is presumed.[402]

9. *That the action of an administrative agency is proper* is presumed.[403]

10. *That the officers conducting an administrative hearing and members of the administrative board behave honestly and fairly in the conduct of the hearings and the decision-making process* is presumed,[404] and rebuttable only by evidence of personal or financial interest on the part of the hearing officer or of misconduct on the officer's part.[405]

Statutory Interpretation and Validity

1. *That the legislature acted with full knowledge of prior legislation and its construction by the courts* is assumed.[406]

2. *That words and phrases in legislation were intended to mean the same throughout an act* is presumed unless it clearly appears to the contrary.[407]

3. *That the legislature tried to comply with the constitutional requirement that the title clearly indicate the subject matter of an act* is presumed.[408]

4. *That the legislature knows the effect of former laws* is presumed.[409]

5. *That Congress knows the content of a statute it is amending* is presumed.[410]

6. *That the legislature was familiar with a Supreme Court decision on the subject matter when enacting a statute* is

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[401] Luter v. Oakhurst Ass'n, 529 So. 2d 889, 894 (Miss. 1988) (Zoning Law); City of Biloxi v. Cawley, 278 So. 2d 389, 390 (Miss. 1973) (Annexation Law); Ballard v. Smith, 107 So. 2d 580, 586 (Miss. 1958) (Speed Law).

[402] State *ex rel.* Moore v. Molpus, 578 So. 2d 624, 643 (Miss. 1991).

[403] Fulce v. Pub. Employees Ret. Sys., 759 So. 2d 401, 403 (Miss. 2000).

[404] *Fulce*, 759 So. 2d at 405.

[405] *Id.*

[406] Ascher & Baxter v. Edward Moyse & Co., 57 So. 299, 304 (Miss. 1912).

[407] Millsaps Coll. v. City of Jackson, 101 So. 574, 575 (Miss. 1924).

[408] Lewis v. Simpson, 167 So. 780, 781 (Miss. 1936).

[409] Gully v. Harrison County, 162 So. 166, 169 (Miss. 1935).

[410] Miss. Poultry Ass'n v. Madigan, 992 F.2d 1359, 1364 (5th Cir. 1993).

presumed.[411]

7. *That statutes are constitutional* is very strongly presumed requiring persuasion beyond a reasonable doubt that a statute is unconstitutional.[412]

8. *That statutes were published as required by the constitution* is conclusively presumed.[413]

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[411] State v. Roell, 7 So. 2d 867, 869 (Miss. 1942).

[412] Lemon v. Miss. Transp. Comm'n, 735 So. 2d 1013, 1015 (Miss. 1999) (finding that statutes authorizing "quicktake" condemnation proceedings are unconstitutional).

[413] Columbus & G. Ry. Co. v. Miller, 134 So. 847, 848 (Miss. 1931).

COMMENT

Modified Joint and Several Liability in Mississippi: The Absent Settling Tortfeasor and the Immune Employer

The Mississippi Supreme Court has clarified some of the law of joint and several liability in Mississippi since the adoption of section 85-5-7 of the Mississippi Code in 1989.[1] Unfortunately, the court does not justify its most recent declarations in *Accu-Fab & Construction, Inc. v. Ladner*[2] and *Mack Trucks, Inc. v. Tackett*[3] with any statutory, case law or relevant secondary authority. In each case, the court held that an employer shall not be apportioned fault in negligence suits brought by one of its employees alleging that the negligence of third party defendant(s) caused his injuries. Accordingly, this article will (1) provide a refreshed perspective of joint and several liability in Mississippi, with particular focus on the treatment of absent settling tortfeasors, and (2) criticize the court's deci-

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[1] *See* MISS. CODE ANN. § 85-5-7 (1999). For comprehensive discussions of the complexities of the statute as it began to be interpreted by Mississippi courts and lawyers, see Cheri D. Green & Michael K. Graves, *Allocation of Fault: Joint Tortfeasors in Court and the Ones Who Should Be*, 63 MISS. L.J. 647 (1994) and H. Wesley Williams, III, *1989 Tort "Reform" in Mississippi: Modification of Joint and Several Liability and the Adoption of Comparative Contribution*, 13 MISS. C. L. REV. 133, 137 (1992).

[2] 778 So. 2d 766 (Miss. 2001).

[3] No. 98-CA-00419-SCT, 2001 WL 171330 (Miss. Feb. 22, 2001).

sion not to include employers in the apportionment process. In doing so, the principles of comparative negligence, joint and several liability and workers' compensation law will be analyzed.

I. COMPARATIVE NEGLIGENCE AND WORKERS' COMPENSATION

Mississippi has adopted pure comparative negligence,[4] as well as several liability.[5] In personal injury actions, the plaintiff's contributory negligence does not bar recovery, "but [his] damages shall be diminished by the jury in proportion to the amount of negligence attributable to" him.[6] Subject to a few exceptions,[7] the defendants' liability for the same injury shall be several only, which means they will only be liable for their own proportionate share of the negligence.[8] Comparative negligence is an "effort to fashion a closer fit between the scope of a defendant's liability and its true equitable contribution to the plaintiff's losses."[9]

However, Mississippi Workers' Compensation Law is a no-fault based system of recovery.[10] An employer is required to

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[4] MISS. CODE ANN. § 11-7-15 (1972). Mississippi was the first state to adopt comparative negligence in 1910. Williams, *supra* note 1, at 150.

[5] *See* MISS. CODE ANN. § 85-5-7(3) (1999) ("the liability for damages caused by two (2) or more persons shall be several only").

[6] MISS. CODE. ANN. § 11-7-15.

[7] In cases where recovery from a defendant cannot be had, for example because the defendant is insolvent, the remaining defendants shall be jointly and severally liable to the extent necessary for the plaintiff to recover 50% of his recoverable damages. MISS. CODE ANN. § 85-5-7(2). Defendants acting in concert to injure a plaintiff are jointly and severally liable. MISS. ANN CODE § 85-5-7(6).

[8] *See* MISS. CODE ANN. § 85-5-7(3) ("the liability for damages caused by two (2) or more persons shall be several only, and not joint and several and a joint tort-feasor shall be liable only for the amount of damages allocated to him in direct proportion to his percentage of fault").

[9] Richard W. Wright, *The Logic and Fairness of Joint and Several Liability*, 23 U. MEM. L. REV. 45, 51 n.19 (1992) (citing 2 A.L.I., REPORTERS' STUDY ON ENTERPRISE RESPONSIBILITY FOR PERSONAL INJURY 149 (1991)). "What pure comparative negligence does is hold a person fully responsible for his/her acts to the full extent to which they cause injury. That is justice." *Id.* at 51 (citing MAINE LIABILITY CRISIS ALLIANCE, RESPONSE TO DRAFT OF THE COMMISSION TO EXAMINE PROBLEMS OF TORT LITIGATION AND LIABILITY INSURANCE IN MAINE, *Appendix-A: Joint and Several Liability*, at A-3 (Oct. 1987)).

[10] *See* MISS. CODE ANN. § 71-3-7 (2000) ("Compensation shall be payable for disability or death of an employee from injury or occupational disease arising out

compensate an injured employee according to statutory guidelines.[11] As a trade-off, the employer has tort immunity.[12] But receipt of compensation does not affect an employee's right to bring an action at law against any other party responsible for the same injuries.[13]

Furthermore, employers (or their compensation insurance carriers) who have tendered compensation payments for injuries or death of an employee are also entitled to repayment of that amount if the employee or its beneficiary is returned a damage award in a suit against third party defendants.[14] In fact, after "reasonable costs of collection" are paid to the employee, the employer recovers as much of the remaining award as is necessary to fully reimburse it for compensation paid or due,[15] regardless of any fault of the employer contributing to the injuries.[16] As a consequence, the employee only recovers if the damage award exceeds this amount of compensation.[17] One purpose of this right of reimbursement under section 71-3-71 is to prevent an unconscionable double recovery by the workers' compensation beneficiary.[18] Additionally, an employer (or its compensation insurer carrier) can join such a suit or maintain one in the name of the employee or his beneficiary as against any other responsible party.[19]

As will be discussed below, whether or not an employer is apportioned fault, comparative negligence and workers' com-

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of and in the course of employment, without regard to fault as to the cause of the injury or occupational disease.").

[11] *See, e.g.*, MISS. CODE ANN. § 71-3-17 (2000) (providing schedule of disability compensation payments).

[12] *See* MISS. CODE ANN. § 71-3-9 (2000) ("The liability of an employer to pay compensation shall be exclusive and in place of all other liability . . . .").

[13] MISS. CODE ANN. § 71-3-71 (2000).

[14] *Id.*

[15] *Id.*

[16] *See* Miss. Food & Fuel Workers' Comp. Trust v. Tackett, 778 So. 2d 136, 143 (Miss. Ct. App. 2000) (stating that employer's right to recover under § 71-3-71 is not conditioned upon "lack of blameworthiness of the employer in the causation of the injury").

[17] § 71-3-71.

[18] United States Fid. & Guar. Co. v. Higdon, 109 So. 2d 329, 333 (Miss. 1959).

[19] § 71-3-71.

pensation may not be seamlessly reconciled, for employers are never made to pay their percentage of negligence contributing to an employee's injuries.

II. SHORT HISTORY OF JOINT AND SEVERAL LIABILITY

Joint and several liability means that each of two or more tortfeasors is liable jointly with the others for the amount of the judgment against them, and that each is also individually liable for the entire amount.[20] The plaintiff can collect from one joint tortfeasor or from any group of them.[21]

At common law, joint and several liability applied only when tortfeasors could be joined in a cause of action, and joinder was strictly limited to situations when tortfeasors acted in concert to injure a plaintiff.[22] One of the original justifications of joint and several liability was that the damages were indivisible and therefore could not be apportioned.[23] Accordingly, "joint tortfeasor" necessarily described one of two or more persons jointly or severally liable in tort for an indivisible injury.[24] However, the term "joint tortfeasor" has lost its meaning at common law.[25] American courts liberalized joinder rules such that "defendants whose negligence has concurred to produce a single result have been joined in one action and by loose usage have been called joint tortfeasors."[26]

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[20] JOHN W. WADE ET AL., PROSSER, WADE AND SCHWARTZ'S TORTS: CASES AND MATERIALS 346 (9th ed. 1990).

[21] *Id.*

[22] William L. Prosser, *Joint Torts and Several Liability*, 25 CAL. L. REV. 413, 414 (1937). Apportioning fault between defendants acting in concert was not allowed. *Id.* The common law did not permit joinder of defendants when their conduct combined to effect a single indivisible injury. *Id.*

[23] *Id.* at 418.

[24] BLACK'S LAW DICTIONARY 839 (6th ed. 1990). Before passage of section 85-5-7, plaintiffs had the option to sue one, all or a select group of tortfeasors and collect full damages from those parties sued. Hall v. Hilbun, 466 So. 2d 856, 879 (Miss. 1985). Therefore, the term joint tortfeasor refers to persons whether or not they are made a party to the lawsuit.

[25] *See* Prosser, *supra* note 22, at 413. "'Joint tort-feasor' is one of those unhappy phrases of indeterminate meaning, whose repetition has done so much to befog the law." *Id.* "'[J]oint tort-feasor' means radically different things to different courts, and often to the same court . . . ." *Id.*

[26] W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS

As an unnecessary consequence, American courts continued to apply joint and several liability to these joint tortfeasors.[27] Prosser concluded this development may be based on the lack of a logical basis for apportionment of damages between defendants.[28] Further confusing the area of law, courts still use the term "joint tortfeasors" to describe joint defendants despite a recent aggressive movement to abolish or modify joint and several liability.[29] Now, most states have apportionment/liability schemes whereby juries assign liability to defendants in direct proportion to their percentage of negligence or fault even if the injury was historically deemed indivisible.[30]

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§ 47, at 328-29 (6th ed. 1990). The cases in which early American courts applied joint and several liability were further broken into rough classifications: "Concerted action," "Vicarious liability," "Common Duty," "Concurrent causation of a single, indivisible result, which neither would have caused alone," "Concurrent causation of a single, indivisible result, which either alone would have caused," "Successive injuries," "Damage of the same kind, which it is difficult to apportion," "Acts innocent in themselves which together cause damage," "Alternative liability." Prosser, *supra* note 22, at 429-42.

[27] *See* KEETON ET AL., *supra* note 26, § 47, at 329 (commenting that courts have "confuse[d] joinder of parties with [the common law notion of] liability for entire damages" while rigidly adhering to the "common law rule that a verdict for one sum must be returned against all those found liable in the joint action"). Prosser commented:

> There is no essential connection between joinder and entire liability. Joinder is a matter of procedural convenience . . . . When defendants who were not joint tort-feasors at common law are joined under the codes, they need not become "joint" for any purpose other than the trial of the case. It is equally unreasonable to deny joinder because there is no entire liability, and to impose such liability because joinder is allowed.

Prosser, *supra* note 22, at 421.

[28] *See* Prosser, *supra* note 22, at 442. "The question is whether, upon the facts, it is possible to say that each defendant is responsible for a separate portion of the loss sustained. The distinction is one between injuries which are capable of being divided, and injuries which are not." *Id.* Before the passage of § 85-5-7 in 1989, Mississippi courts imposed joint and several liability in five identifiable situations: (1) concerted action, (2) common duty, (3) vicarious liability, (4) concurrent negligence, and (5) alternative liability. Williams, *supra* note 1, at 137.

[29] *See, e.g.*, Narkeeta Timber Co. v. Jenkins, 777 So. 2d 39, 42 (Miss. 2000); Fielder v. Magnolia Beverage Co., 757 So. 2d 925, 934-35 (Miss. 1999); Peterson v. Ladner, No. 1998-CA-01672-COA, 2000 WL 864473 (Miss. Ct. App. June 27, 2000); *see also* Kathleen M. O'Connor & Gregory P. Sreenan, *Apportionment of Damages: Evolution of a Fault-Based System of Liability for Negligence*, 61 J. AIR L. & COM. 365, 374 (1996) (assessing tort reform "movement toward equating liability to fault").

[30] For a good breakdown of the types of liability schemes used in all fifty-one

As an example of the erroneous use of "joint tortfeasors" as it was known at English common law and earlier American law, Mississippi now provides by statute that a "joint tort-feasor shall be liable only for the amount of damages allocated to him in direct proportion to his percentage of fault."[31]

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jurisdictions, see Conner & Sreenan, *supra* note 29, at 374-81.

[31] MISS. CODE ANN. § 85-5-7(3) (1999).

III. MODIFICATION OF JOINT AND SEVERAL LIABILITY IN MISSISSIPPI: MISS. CODE ANN. § 85-5-7[32]

Mississippi has joined the majority of states that have abolished or modified joint and several liability.[33] The gener-

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[32] For ease of reference, MISS. CODE ANN. § 85-5-7 is included in its entirety:

(1) As used in this section "fault" means an act or omission of a person which is a proximate cause of injury or death to another person or persons, damages to property, tangible or intangible, or economic injury, including but not limited to negligence, malpractice, strict liability, absolute liability or failure to warn. "Fault" shall not include any tort which results from an act or omission committed with a specific wrongful intent.
(2) Except as may be otherwise provided in subsection (6) of this section, in any civil action based on fault, the liability for damages caused by two (2) or more persons shall be joint and several only to the extent necessary for the person suffering injury, death or loss to recover fifty percent (50%) of his recoverable damages.
(3) Except as otherwise provided in subsections (2) and (6) of this section, in any civil action based on fault, the liability for damages caused by two (2) or more persons shall be several only, and not joint and several and a joint tort-feasor shall be liable only for the amount of damages allocated to him in direct proportion to his percentage of fault. In assessing percentages of fault an employer and the employer's employee or a principal and the principal's agent shall be considered as one (1) defendant when the liability of such employer or principal has been caused by the wrongful or negligent act or omission of the employee or agent.
(4) Any defendant held jointly liable under this section shall have a right of contribution against fellow joint tort-feasors. A defendant shall be held responsible for contribution to other joint tort-feasors only for the percentage of fault assessed to such defendant.
(5) Nothing in this section shall eliminate or diminish any defenses or immunities which currently exist, except as expressly noted herein.
(6) Joint and several liability shall be imposed on all who consciously and deliberately pursue a common plan or design to commit a tortious act, or actively take part in it. Any person held jointly and severally liable under this section shall have a right of contribution from his fellow defendants acting in concert.
(7) In actions involving joint tort-feasors, the trier of fact shall determine the percentage of fault for each party alleged to be at fault.
(8) Nothing in this section shall be construed to create a cause of action. Nothing in this section shall be construed, in any way, to alter the immunity of any person.

MISS. CODE ANN. § 85-5-7.

[33] HENRY WOODS & BETH DEERE, COMPARATIVE FAULT, § 13:4, at 234 (3d ed. 1996).

al rule is laid down in section 85-5-7(3): "liability for damages caused by two (2) or more persons shall be several only, and not joint and several and a joint tort-feasor shall be liable only for the amount of damages allocated to him in direct proportion to his percentage of fault."[34] However, defendant(s) remain jointly and severally liable, when liability for damages is caused by two or more persons, only to the extent necessary for the plaintiff to recover 50% of his recoverable damages.[35] And, a jury *may* apportion fault to each "party" alleged to be at fault.[36] "Party" includes settling defendants.[37] However, joint and several liability is not imposed in every suit in which two persons have proximately caused a plaintiff's injuries, but rather only in circumstances when one "person" can not (insolvent) or is not required to (immune) pay his percentage of several liability.[38]

Consider a hypothetical: P sues A, B and C. The jury finds damages in the amount of $100,000, and apportions fault P-40%, A-20%, B-20% and C-20%. The recoverable damages, after reducing P's fault, would be $60,000, so A, B and C would be jointly and severally liable for half of that amount, or $30,000. In the event that A and B are insolvent, for example, C would be responsible for $20,000, plus an extra $10,000.[39]

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[34] MISS. CODE ANN. § 85-5-7(3); *see also* Whitehead v. Food Max, Inc., 163 F.3d 265, 280 (5th Cir. 1998) (interpreting "general rule").

[35] *See* MISS. CODE ANN. § 85-5-7(2). A plaintiff "cannot recover damages from herself; therefore, 'recoverable damages' represent those damages attributable to other parties." Depriest v. Barber, No. 2000-CA-003838-SCT, 2001 WL 302117, *2 (Miss. March 29, 2001). "If a defendant's share of fault is 50% or less, Miss. Code Ann. § 85-5-7(2) limits the payment obligation to 50% of the total recoverable damages." *Id.* (citation omitted).

[36] MISS CODE ANN. § 85-5-7(7).

[37] Estate of Hunter v. Gen. Motors Corp., 729 So. 2d 1264, 1276 (Miss. 1999); *see also infra* note 40 and accompanying text.

[38] If each party pays his percentage of fault, joint and several liability will not be applied because the plaintiff will have recovered 100% of his recoverable damages. *See* Mack Trucks, Inc. v. Tackett, No. 98-CA-00419-SCT, 2001 WL 171330, at *5 (Miss. Feb. 22, 2001) ("Implicitly, [§ 85-5-7] assumes that an injured party will be made whole by the several tortfeasors absent insolvency."). It will not apply if one solvent party pays his percentage of fault, which is equal to or in excess of 50% or recoverable damages. *See* MISS. CODE ANN. § 85-5-7(2).

[39] For a Mississippi case releasing defendants from their joint and several

IV. Apportionment of Fault to Absent Settling Defendants

What happens to the hypothetical if A has settled with P prior to or during trial? In the landmark case of *Estate of Hunter v. General Motors Corp.*, the Mississippi Supreme Court approved apportionment of fault to absent settling tortfeasors.[40] But while *Hunter* permits apportionment to these tortfeasors, section 85-5-7(7) suggests that the parties to the lawsuit control which "part[ies]" shall be submitted to the jury for apportionment of fault.[41] In fact, once a party asks

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obligation once they paid 50% of the plaintiffs recoverable damages, see Narkeeta Timber Co. v. Jenkins, 777 So. 2d 39 (Miss. 2000). The jury returned a verdict in favor of plaintiff, apportioning fault to the two defendants, Koehn 80%, and Narkeeta 20%, with total damages of $2,051,066. *Id.* at 40. The defendants were jointly and severally liable for half of the recoverable damages, or $1,025,533. *Id.* at 42. When the court rendered its decision, Koehn had paid only $100,000 (of his proportionate share of $1,640,852.80) and Narkeeta had paid $925,533 ($515,319.80 in excess of its proportionate share) equaling the same $1,025,533. *Id.* The court held that the judgments against Narkeeta were satisfied and cancelled because 50% of the recoverable damages had been paid. *Id.*

[40] 729 So. 2d 1264, 1276 (Miss. 1999) (holding "party" as it is used in section 85-5-7(7) means "any participant to an occurrence which gives rise to a lawsuit, and not merely parties to a particular lawsuit or trial"); *see also* Dawson v. Townsend & Sons, Inc., 735 So. 2d 1131, 1136 (Miss. Ct. App. 1999) ("What *Estate of Hunter* answers is that the presence or absence of tortfeasors as defendants named in the suit is irrelevant."). A current portion of the Mississippi Supreme Court is strongly opposed to a *Hunter* interpretation of "party" in section 85-5-7(7). *See Hunter*, 729 So. 2d at 1281 (McRae, J., concurring and dissenting) ("[T]he trier of fact only determines fault percentages for parties alleged to be at fault. One may be alleged to be at fault only if one is named in the lawsuit.").

[41] *See* § 85-5-7(7). This section states a jury "may" apportion fault to an absent-settling defendant so long as that party is "alleged to be at fault." *Id.* Trial judges may, however, have ultimate control over the parties to be apportioned fault. *See Hunter*, 729 So. 2d at 1272 ("[T]his Court in *McBride* implicitly acknowledged that trial judges have the option of permitting juries to consider the fault of settling defendants by limiting the holding therein to cases in which the trial judge had *not* permitted the jury to consider the negligence of all parties."). *But see* Peterson v. Ladner, No. 1998-CA-01672-COA, 2000 WL 1669873, at *2 (Miss. Ct. App. Nov. 7, 2000) ("[I]t is clear that a non-exempt contributor to an injury must have fault allocated *if that is requested by a party to litigation.*") (emphasis added).

One operating inference must be noted. The plaintiff can only seek to apportion fault to parties whose negligence he has alleged in his complaint or amended

the judge to let the jury apportion fault to a particular person, his failure to do so is reversible error.[42] Accordingly, two theories of reduction may apply depending on whether the absent settling tortfeasor is apportioned fault.

A. Settlement-first Doctrine—Pro Tanto Reduction[43]

If A is not apportioned fault, then the respective percentages of fault of P, B and/or C (in the above hypothetical) would necessarily increase in order allocate all 100% of fault. For example, A settles with P for $30,000 and the jury apportions fault P-40%, B-30% and C-30%. In order to determine P's recoverable damages, the court must first subtract the $30,000 settlement between A and P from $100,000 to get $70,000. The $70,000 is then further reduced by P's 40%, to get the recoverable damages award of $42,000. Ultimately, B and C would each be liable for $21,000 and would be jointly and severally liable for the same $21,000.[44] The plaintiff's recov-

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pleadings has contributed to his injuries. This is the only avenue for the plaintiff to allege parties at fault. The defendants, in turn, can raise the negligence of parties (including non-parties and absent settling tortfeasors) in their own pleadings.

[42] *Peterson*, 2000 WL 1669873, at *2. For qualification of this statement, see *infra* note 66 and accompanying text.

[43] Under this method of apportionment, "a settlement reduces the judgment against remaining defendants dollar for dollar." Krieser v. Hobbs, 166 F.3d 736, 739 (5th Cir. 1999); *see also* 22 AM. JUR. 2D *Damages* § 559 (1988) ("The consideration received by one injured as a consequence of a tort committed by two or more tortfeasors operates to reduce, pro tanto (to the same extent), the amount of damages he is entitled to recover against any other tortfeasor responsible for his injures.").

In 1996, Mississippi adopted the "settlement-first" method of reduction when a jury does not consider the fault of absent-settling defendants. McBride v. Chevron U.S.A., 673 So. 2d 372, 380 (Miss. 1996). The court explicitly limited its opinion "to cases in which, as here, the trial court instructed the jury to consider only the relative culpabilities of the plaintiff and the non-settling defendant(s) in apportioning fault under comparative negligence principles." *Id.* In *McBride*, the jury awarded $500,000 in damages, and apportioned 75% fault to the plaintiff. *Id.* at 375. In calculating the liability of the non-settling defendant under the settlement first doctrine, the court subtracted a $150,000 settlement award from the damages ($500,000 minus $150,000 = $350,000) before it reduced the recoverable damages by the plaintiff's proportionate fault ($350,000 less 75%). *Id.* The non-settling defendant was liable for $87,500. *Id.*

[44] In this case B and C are equally at fault. If B is apportioned 50% and C

ery, taking into account the settlement amount, would be $72,000.

This method, which adjusts a verdict against a defendant to reflect an earlier settlement,[45] was applied most recently in *Mack Trucks, Inc. v. Tackett*.[46] The jury assessed total damages at $1.8 million.[47] Because the plaintiff had settled with one defendant for $330,000, the judgment was accordingly reduced to $1,470,000.[48] This award was further reduced

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is apportioned 10%, then B would be responsible for $35,000, and C for $7,000 (50% and 10% of $70,000 respectively). The only situation in which C would be jointly and severally liable for half of the recoverable damages, or $21,000 (in this case $14,000 in excess of his proportionate fault), is when B is insolvent.

[45] *Hunter*, 729 So. 2d at 1267. Pro-tanto reduction fittingly applies when a plaintiff has overlapping remedies—in these cases, settlements and judgments. *See Hobbs*, 166 F.3d at 740 (stating that settlements and judgments in joint and several liability jurisdictions are overlapping). If jointly and severally liable in a comparative negligence jurisdiction, non-settling defendants were liable individually or as a group for the entire amount of the damages not attributable to the plaintiff. *See supra* notes 6, 21 and accompanying text. In order to prevent multiple recovery (in excess of the damage award), courts reduced the non-settling defendants' liability by subtracting from the plaintiff's damage award, pro-tanto (dollar for dollar), the settlement amount. *Hobbs*, 166 F.3d at 740. Now consider the consequent proportionate liability of non-settling defendants if a partly negligent defendant settles with the plaintiff and is subsequently left of out the apportionment process. Their proportionate liability would likely increase. *See* Mack Trucks, Inc. v. Tackett, No. 98-CA-00419-SCT, 2001 WL 171330, at *5 (Miss. Feb. 22, 2001) (imputing negligence apportioned to employer to non-settling defendants without disrupting percentage apportioned to plaintiff). Without reduction, the plaintiff benefits from multiple recoveries (increased liability of non-settling defendants plus settlement). Pro-tanto reduction prevents the plaintiff from recovering a windfall by reducing the award (liability minus settlement).

[46] *Mack Trucks*, 2001 WL 171330, at *6. The Court has "opine[d] that a pro-tanto credit for non-settling tortfeasors is incompatible with § 85-5-7." Peterson v. Ladner, No. 1998-CA-01672-COA, 2000 WL 864473 (Miss. Ct. App. June 27, 2000). But importantly, the issue was not resolved in that case because it was reversed for failure to apportion fault to an absent settling tortfeasor. *Id.* Without affecting the pro-tanto reduction rule in cases in which absent settling defendants *are not* apportioned fault, the court's statement serves only to strengthen the applicability of proportionate reduction when absent tortfeasors *are* apportioned fault. Plus, the Mississippi Supreme Court has applied pro-tanto reduction since then in *Mack Trucks*.

[47] *Mack Trucks*, 2001 WL 171330, at *3.

[48] *Id.* at *3, *6 (affirming this part of trial court's division of damages). The settling defendant, Freightliner, was not included in the apportionment process. *Id.* at *3.

by the plaintiff's 60% fault to $588,000.[49] The remaining defendants were jointly and severally liable for half of that, or $294,000.[50]

B. Proportionate Share Reduction[51]

After A settles with P for $30,000, the jury determines damages are $100,000, the court submits A into the apportionment process and the jury finds P-40%, A-20%, B-20% and C-20%.[52] After reducing the damages by P's 40%, the plaintiff's recoverable damages are $60,000. The settlement award of $30,000 cancels out A's proportionate share of 20%. B and C are liable for their proportionate share, or $20,000 each. B and C would be jointly and several liable for $10,000.[53] The plaintiff's recovery, taking into account his settlement with A, would be $70,000.[54]

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[49] *Id.* at *3, *6 (affirming this part of trial court's division of damages).

[50] *Id.* at *6 (affirming this part of trial court's division of damages). Even though the court determined Wilburn Oil, the plaintiff's employer who was immune from tort liability, was erroneously injected into the fault allocation equation, the court held the two defendants (collectively 1% at fault, or $14,700 of $588,000) jointly and severally liable for $294,000 notwithstanding the jury's apportionment of a significant majority of the remaining damages (39%, or $573,000 of $588,000) to Wilburn Oil. *Id.* at *3, *5, *6. For a more detailed discussion of the opinion and its inherent inconsistencies, see *infra* notes 76-85 and accompanying text.

[51] *See* 22 AM. JUR. 2D *Damages* § 561 (1988) ("The rule that recovery from nonsettling tortfeasors is reduced pro tanto by the amount received in settlement from another tortfeasor may be affected by a comparative negligence statute that apportions negligence to each party, including each of the defendants. If the statute provides that each tortfeasor is responsible for the percentage of negligence attributed to him, the judgment against each defendants is not reduced by the amount of a settlement paid be the other tortfeasors.").

[52] Once a settling tortfeasor is apportioned, pro-tanto reduction is no longer appropriate. *Hunter*, 729 So. 2d at 1267.

[53] In order to determine the amount for which the non-settling defendants are jointly and severally liable (here, $10,000), the court simply subtracts an amount equal to the absent settling tortfeasors' proportionate share of the damages (here, $20,000) from 50% of the recoverable damages (here, $30,000). Under proportionate reduction, the court does not consider whether the settlement amount is greater or lesser than A's proportionate share. The court would be applying pro-tanto reduction if it reduced the damages by the actual settlement award.

[54] Under these facts, the plaintiff recovers a windfall ($10,000 in excess of the damages award). *See infra* note 60.

The Fifth Circuit Court of Appeals, applying Mississippi law, used this method in *Krieser v. Hobbs*.[55] The plaintiff settled with one defendant during trial for $650,000.[56] At trial, the jury assessed damages at $200,000, and apportioned fault between the plaintiff, the settling defendant and two remaining defendants at P-0%, D_S-50%, D_1-50% and D_2-0%.[57] Despite a settlement which exceeded the total damages award, the court found D_1 liable for his 50% share, or $100,000.[58] The court predicted the Mississippi Supreme Court would hold that "the amount of damages apportioned to a non-settling defendant is not reduced by a settlement by another defendant" when the settling defendant is also apportioned fault.[59]

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[55] Krieser v. Hobbs, 166 F.3d 736, 744-45 (5th Cir. 1999). In the Restatement, absent settling tortfeasors are apportioned fault in each of five Tracks which represent different liability schemes (including, e.g., joint and several, several and joint with reallocation devices). *See* RESTATEMENT (THIRD) OF TORTS: APPORTIONMENT OF LIABILITY §§ A19, B19, C19, D19, E19 (2000). The Restatement applies proportionate reduction under every track. *See id.* § B19 cmt. k:

> No rule is provided to govern a settlement with one or more but less than all *severally* liable tortfeasors . . . . Because each tortfeasor is liable only for its comparative share of the plaintiff's damages, there are no contribution claims. Because there are no contribution claims, the question of credit for the nonsettling defendant does not arise. Nevertheless, the final apportionment of responsibility to the nonsettling defendant is identical whether the settlement occurs pursuant to the rules stated in this Track "B" or the rules stated in the other Tracks. As when joint and several liability is the governing rule, the plaintiff may recover more than the total damages determined by the factfinder as a result of making a beneficial settlement with some tortfeasors.

(emphasis added).

[56] *Hobbs*, 166 F.3d at 738.

[57] *Id.*

[58] *Id.* at 745, 747. "It is the view of this Court that a defendant whose negligence has been found to have proximately caused injury to another person should not be allowed to escape liability for his negligence by the fortuity that a co-defendant has settled prior to trial." *Id.* (citing McBride v. Chevron U.S.A., 673 So. 2d 372, 380 (Miss. 1996)). D_1 was not jointly and severally liable for any amount in excess of his proportionate fault because D_S tendered his settlement which represented 50% of fault and half of the recoverable damages.

[59] *Id.* at 745. The opinion provides a long discussion of pro-tanto reduction, listing sixteen states which have abolished the method (Arizona, California, Colorado, Florida, Indiana, Iowa, Kansas, Kentucky, New Jersey, New Mexico, Pennsylvania, Tennessee, Texas, Washington, West Virginia and Wyoming), ultimately stating: "the majority rule is decidedly that a *pro-tanto* . . . rule has *no* applica-

Similar to the hypothetical, the plaintiff reaps the reward of a beneficial settlement.[60]

While Mississippi courts have struggled to label its modified scheme of liability,[61] they have justified apportionment of fault to absent settling tortfeasors[62] (and perhaps even non-

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tion to liability no longer both joint *and* several." *Id.* at 743-44 (citation omitted). However, not only has the Mississippi Supreme Court applied pro-tanto reduction since *Hobbs* (in *Mack Trucks* where the absent settling defendant was not apportioned fault), but also the parties to the litigation control which absent parties may be apportioned fault. *See supra* notes 39, 44-48 and accompanying text. If absent parties are not apportioned fault, then the damage award could not be reduced proportionately, and without a second method of reduction, like pro-tanto, the plaintiff would receive a windfall. Take *Hobbs* as an example. If D_s were left out of the apportionment process, then the non-negligent plaintiff would receive the entire $200,000 damage award from D_1, plus the $650,000 settlement. *See supra* notes 55-58 and accompanying text; *see also* RESTATEMENT (THIRD) OF TORTS: APPORTIONMENT OF LIABILITY, § B19 cmt. k illus. (2000).

[60] However, the plaintiff also bears the risk of an inadequate settlement. *Hobbs*, 166 F.3d at 745. In the hypothetical above, if A had settled for $10,000, the P would have recovered only $50,000. *See supra* text p. 10. Neither proportionate share nor pro-tanto reduction alters the likelihood of settlement. *See McBride*, 673 So. 2d at 379 ("Our law favors settlement for many reasons, not the least of which includes the expeditious closure of cases.").

[61] *Compare* Estate of Hunter v. Gen. Motors Corp., 729 So. 2d at 1274 ("The principal effect of § 85-5-7 is that it abolishes joint and several liability for up to 50% of the plaintiff's injuries and replaces it with several liability up to this amount."), *with* Narkeeta Timber Co. v. Jenkins, 777 So. 2d 39, 42 (Miss. 2000) ("§ 85-5-7 does not abolish joint and several liability for up to 50% of the plaintiff's injuries and replace it with several liability . . . . Rather, [it] . . . abolishes joint and several liability over 50% of the judgment and leaves untouched joint and several liability up to 50% of the judgment.").

[62] Construing "party," as it is used in section 85-5-7(7), to mean only the parties to the lawsuit would inappropriately grant in the plaintiff the "exclusive right to make allegations of fault before a jury and to deprive defendants of the opportunity to persuade a jury that fault for a given accident lies elsewhere." *Hunter*, 729 So. 2d at 1273-74. In *Hunter*, the court also stated:

> A rule of law limiting a jury to a consideration of the fault of the parties at trial would permit a plaintiff to settle with a defendant primarily responsible for a given accident, file suit against a "deeper pockets" defendant who may bear little if any responsibility for the accident, and thereupon require the jury to allocate all of the responsibility for the plaintiff's injuries between the plaintiff and the non-settling defendant. It would be patently unfair in many cases to require a defendant to be "dragged into court" for the malfeasance of another and to thereupon forbid the defendant from establishing that fault should properly lie elsewhere. Such a procedure invites inequitable results which, in certain cases, could arguably rise to the level of a due process violation. . . . Thus, [§ 85-5-7]

parties).[63] Under the law, counsel now has the *choice* to ap-

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serves to reduce the extent to which one defendant may be held liable for the negligence of another.

Id. (footnote omitted). Another court, agreeing with *Hunter*, stated:

> [A] plaintiff could select which of several tortfeasors to sue, based on considerations other than degree of culpability, and the defendants could not bring the other tortfeasors into the litigation. If the statute did not permit missing participants in the injury to have an allocation of responsibility made to them, a fairly minor contributor factually could become the sole party at fault legally.

Dawson v. Townsend & Sons, Inc., 735 So. 2d 1131, 1134 (Miss. Ct. App. 1999).

The courts have relied on other jurisdictions, including Tennessee and Florida, for support. *Hunter*, 729 So. 2d at 1275. "Clearly, the only means of determining a party's percentage of fault is to compare that party's percentage to all of the other entities who contributed to the accident, regardless of whether they have been or could have been joined as defendants." *Id.* at 1274. (citing Fabre v. Marin, 623 So. 2d 1182, 1185 (Fla. 1993)). "[F]airness and efficiency require that defendants called upon to answer allegations in negligence be permitted to allege, as an affirmative defense, that a nonparty caused or contributed to the injury or damage for which recovery is sought." *Id.* at 1275 (citing Ridings v. Ralph M. Parsons Co., 914 S.W.2d 79, 81 (Tenn. 1996)); *see also* KEETON ET AL., *supra* note 26, § 67, at 427 ("[T]he failure to consider the negligence of all tortfeasors, whether parties or not, prejudices the joined defendants who are thus required to bear a greater portion of the plaintiff's loss than attributable to their fault.").

[63] This issue is beyond the scope of this article, but it is arguable that Mississippi courts are amenable to apportionment of non-parties. A non-party is someone the plaintiff has neither settled with nor sued. Joinder of third party defendants is extremely limited and largely unavailable to defendants in Mississippi. *See* MISS. R. CIV. P. 14 cmt.:

> It is essential that the third-party claim be for some form of derivative or secondary liability of the third-party defendant to the third-party plaintiff. Third-party practice is not a general device for bringing in additional parties to the action. It is not available for example, to bring in a party solely on the ground that he is or may be liable to the original plaintiff. . . . Thus, an allegation that the third party is a joint tortfeasor or is the one really liable to the original plaintiff is insufficient to state a third-party claim.

MISS. R. CIV. P. 14 cmt. (citations omitted). Defendants need not join absent settling defendants, for juries will apportion fault to them when they are not parties to a lawsuit so long as they are alleged to be at fault. *See Hunter*, 729 So. 2d at 1274. So, in all likelihood, the court in *Hunter* was referring to non-parties when it stated, "[g]iven that it is thus apparent that, fairly or unfairly, contribution and impleader remain largely unavailable to defendants in this State, it becomes particularly important in the context of this State's jurisprudence that the plaintiff not be given the sole power to determine among which parties the jury is able to allocate fault." *Id.* at 1276.

portion fault to any participant to an occurrence which gives rise to the lawsuit.[64]

C. Practical Implications of Apportionment Choices

In practice, parties to the lawsuit will decide whether to ask the jury to apportion fault to an absent settling tortfeasor based on: (1) how much they believe the damages are, (2) any settlements between the plaintiff and tortfeasors, (3) whether they feel a settlement award would exceed or fall below the settling tortfeasor's proportionate share of negligence if left in the apportionment process (given what they could prove at trial), (4) the relative culpability of the plaintiff and tortfeasors, and (5) the relative solvency or immunity of the tortfeasors. In theory, for example, defendants would favor a pro-tanto reduction without apportionment if they feel the plaintiff has settled for an amount that would be in excess of that absent party's percentage of the negligence, while the plaintiff would favor a proportionate reduction with apportionment if he made the same assumption. Consider a hypothetical: P sues A (a solvent corporation) and B, but settles with A for $30,000. If B believes that the damages are $100,000, and that A will be found 20% at fault ($20,000), B would not want A's fault apportioned, but P would. No clear choice is always favorable over the other, for the myriad of possible answers to (1)-(5) can never be estimated with certainty.

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[64] *Hunter*, 729 So. 2d at 1276. The Restatement employs proportionate reduction regardless of whether a jurisdiction retains joint and several liability or has now adopted several liability; but, absent settling tortfeasors are always apportioned fault. *See* RESTATEMENT (THIRD) TORTS: APPORTIONMENT OF LIABILITY §§ A19, B19 & C19 (applying, respectively, to jurisdictions with joint and several liability, several liability, and joint and several liability with reallocation devices). Contrary to Mississippi practice where parties to the lawsuit decide who is apportioned fault, *see supra* note 41 and accompanying text, the language of the Restatement sections and the applicable comments appear to *require* apportionment of fault to absent tortfeasors so long as a fact finder might find them at fault. *See id.* § B19 (requiring each settling tortfeasor who may be found by factfinder to have engaged in tortuous conduct that was legal cause of plaintiff's injury to be submitted to factfinder for assignment of percentage of comparative responsibility); *see also supra* note 55.

While minimal statutory direction provides that parties to be apportioned must be alleged to be at fault,[65] it is unclear how different judges handle this issue. However, a plaintiff should always be on notice that the defendant may attempt to place any or all the blame on the settling defendant (and the plaintiff).[66] If the plaintiff settles before trial, perhaps the defendant will either have to plead that the negligence of a settling tortfeasor contributed to the plaintiff's injuries, or otherwise put the plaintiff on notice that he intends to have that party submitted to the jury for apportionment of fault. Regardless, a plaintiff should put on evidence tending to show that the settling defendant was only partially negligent and the non-settling defendants were substantially negligent.

After *Hunter*, courts will allow parties to apportion fault among all parties to the lawsuit as well as absent settling tortfeasors, but counsel's decision to apportion fault to a party determines which method of damages reduction will apply. So before any decisions are made, counsel should consider several

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[65] MISS. CODE ANN. § 85-5-7(7) (1999). In *Hunter*, the court rejected plaintiff's argument that a jury's right to apportion fault to settling defendants would "improperly shift responsibility to parties not present before the jury," stating "[t]he fact remains . . . that plaintiffs . . . can and do attempt to establish to the jury that fault for the accident in question properly lies with the defendants at trial rather than with any absent parties." *Hunter*, 729 So. 2d at 1276. The court went on to argue that "[a]t trial below, counsel for the plaintiffs effectively stood in the shoes of the settling defendant . . . and argued that he bore little if any of the responsibility for the injuries which the plaintiffs suffered." *Id.*

[66] *See, e.g.*, ARIZ. REV. STAT. § 12-2506 (1994 & Supp. 2000) (defending party must give notice of its intention to have non-parties negligence considered, but no such requirement applies to settling non-party); COLO. REV. STAT. § 13-21-111.5(3)(b) (2000) (defending party must give notice to claimant of its intention to show that non-party is negligent, but no such requirement applies to settling tortfeasors). In jurisdictions where juries may seek to apportion fault to settling defendants or non-parties, common sense should sound alarms within the plaintiffs that non-settling defendants will attempt to shift any and all blame on settling defendants. *See, e.g.*, ALASKA STAT. § 09.17.080 (Michie 1998); CONN. GEN. STAT. § 52-572h (1991 & Supp. 2001); IOWA CODE ANN. §§ 668.3, 668.7 (West 1998); KY. REV. STAT. ANN. § 411.182 (Michie 1992); LA. CIV. CODE ANN. art. 2323 (West 1997); MICH. COMP. LAWS ANN. § 600.6304 (West 2000); MONT. CODE ANN. § 27-1-703 (2000); N.M. STAT. ANN. § 41-3A-1 (Michie 1996); N.D. CENT. CODE § 32-03.2-02 (1996); UTAH CODE ANN. § 78-27-39 (1996); WASH. REV. CODE ANN. § 4.22.070 (West 1988 & Supp. 2001); WYO. STAT. ANN. § 1-1-109 (Michie 1999).

factors bearing on the relative merits of pro-tanto and proportionate share reduction under the circumstances. Plus, that party may lose its apportionment options if it fails to timely notify the judge and the litigants of its decision.

V. MISSISSIPPI'S RESOLUTION OF APPORTIONMENT OF FAULT TO AN IMMUNE EMPLOYER

The answer is clear. While *Hunter* still applies to apportionment of absent settling tortfeasors, employers immune from tort liability in suits brought by their employees against third party tortfeasors shall not be submitted to the jury for apportionment of fault.[67]

A. Accu-Fab & Construction, Inc. v. Ladner[68] and *Mack Trucks, Inc. v. Tackett*[69]

In *Accu-Fab & Construction, Inc. v. Ladner*, the trial court denied defendants' motions to submit Bracken (decedent's employer) into the apportionment process.[70] The jury returned a verdict in favor of Ladner's (decedent) heirs in the amount of $2,000,000, apportioning 5% fault to Ladner, 70% to Anderson and 25% to Accu-Fab.[71]

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[67] *See* Accu-Fab & Constr., Inc. v. Ladner, 778 So. 2d 766, 770 (Miss. 2001); Mack Trucks, Inc. v. Tackett, No. 98-CA-00419-SCT, 2001 WL 171330, at *1 (Miss. Feb. 22, 2001).

[68] *Accu-Fab*, 778 So. 2d 766.

[69] *Mack Trucks*, 2001 WL 171330. The court handed down two cases, *Accu-Fab* and *Mack Trucks*, with the same holding on the same day, yet neither case made mention of the other, nor did they mutually rely on any specific policy or law. Although the opinion in *Mack Trucks* is exceedingly problematic, this article will address only the portions dealing with apportionment.

[70] *Accu-Fab*, 778 So. 2d at 767. Boomtown, Inc. hired Roy Anderson Corp. to construct a casino. *Id.* In turn, Anderson, the general contractor, hired two subcontractors, Accu-Fab & Construction, Inc. and Bracken Construction Co. *Id.* During construction, Richard Ladner, Bracken's employee, fell through a hole in the roof of the casino. *Id.* at 768. With Anderson's permission, Accu-Fab had cut the hole to "facilitate the installation of the stairway." *Id.* at 767. However, neither Anderson nor Accu-Fab placed signs around the hole to warn of the danger. *Accu-Fab*, 778 So. 2d at 767-68. Ladner died from injuries in the fall, and his heirs sued Anderson and Accu-Fab. *Id.* at 768.

[71] *Id.*

On appeal, the Mississippi Supreme Court affirmed the ruling of the trial court on apportionment, holding "it would not be proper to reduce the award against Accu-Fab and Anderson in proportion to the fault of Ladner's employer, Bracken."[72] The court implicitly declined to extend the *Hunter* definition of "party" as used in section 85-5-7(7) to include immune employers.[73] In doing so, the court misread the two authorities it cited—an Iowa Law Review article[74] and a Connecticut Supreme Court case[75]—in support of its holding.

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[72] *Id.* at 770. The court's analysis deals primarily with maritime law and The Longshoremen's and Harbor Workers' Compensation Act (LHWCA), but the court stated, "we would reach the same conclusion even if the [LHWCA] was not implicated." *Id.*

[73] The court did not distinguish the applicability of policies evinced in *Hunter* after quoting from that opinion:

> This Court agrees with the aforementioned commentators that the policy considerations underlying the comparative fault doctrine would best be served by the jury's consideration of the negligence of all participants to a particular incident which gives rise to a lawsuit. A rule of law limiting a jury to a consideration of the fault of the parties at trial would permit a plaintiff to settle with a defendant primarily responsible for a given accident, file suit against a "deeper pockets" defendant who may bear little if any responsibility for the accident, and thereupon require the jury to allocate all of the responsibility for the plaintiff's injuries between the plaintiff and the non-settling defendant.

Id. at 770-71 (citing Estate of Hunter v. Gen. Motors Corp., 729 So. 2d 1264, 1273 (Miss. 1999)).

[74] Jonathan Cardi, *Apportioning Responsibility to Immune Nonparties: An Argument Based on Comparative Responsibility and the Proposed Restatement (Third) of Torts*, 82 IOWA L. REV. 1293 (1997). The article, however, states, "[i]t must be noted that the theories and solutions advocated by this Note should not be applied to the immunity created by workers' compensation statutes . . . . [S]tate courts and legislatures have already installed fine-tuned apportionment, subrogation, and settlement schemes to accommodate the unique circumstances of employer liability." *Id.* at 1298 (footnote omitted).

[75] Durniak v. August Winter & Sons, Inc., 610 A.2d 1277 (Conn. 1992). The Connecticut opinion deals with pleading and statutory causes of action rather than apportionment. *Id.* at 1278-81. The employer intervened as a party plaintiff (a right similarly afforded employers under MISS. CODE ANN. § 71-3-71 (2000)), and the defendant subsequently filed an amended answer alleging the contributory negligence of the employer should reduce its recovery. *Id.* at 1280. The Connecticut court stated that the employer's recovery would not be reduced by its contributory negligence because its statutory cause of action against the defendant did not fall within those acts contemplated in the Connecticut comparative negligence statute. *Id.* at 1279. But more importantly, the court qualified its opinion,

In *Mack Trucks, Inc. v. Tackett*, the wrongful death beneficiary of Tony Joe Murphree brought suit against Mack Trucks, Freightliner and Cummins.[76] During trial, the plaintiff settled with Freightliner for $330,000.[77] Ultimately, the jury returned a verdict in favor of the beneficiary in the amount of $1,800,000, apportioning 60% fault to Murphree, 39% to Wilburn Oil (Murphree's employer), .75% to Mack Trucks and .25% to Cummins.[78] After reducing the damages award by the settlement and Murphree's proportionate share of the negligence, the trial court found Mack Trucks and Cummins jointly and severally liable for half of the remaining $588,000 because the share apportioned to Wilburn Oil, an employer with tort immunity, was uncollectible.[79]

On appeal, the Mississippi Supreme Court concluded the trial court properly found Mack Trucks and Cummins jointly and severally liable for Wilburn Oil's portion of fault.[80] The court reasoned that an employer should not be apportioned

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stating, "[a] different result might also follow if, instead of relying on a special defense alleging the intervening employer's negligence, the defendant, having filed a general denial, sought to make an evidentiary showing that it was the employer's conduct rather than the defendant's conduct that had proximately caused the employee's injuries." *Id.* at 1280-81 n.5 (citing Williams v. Union Carbide Corp., 734 S.W.2d 699, 703 (Tex. App. 1987)).

[76] *Mack Trucks*, 2001 WL 171330, at *1. Tony Joe Murphree, an employee of Wilburn Oil, sustained severe injuries in an explosion related to a gas leak while he and another unloaded fuel from two trucks (one a Mack, the other a Freightliner). *Id.* At the time of the explosion, the engines (one a Mack, the other a Cummins) of both trucks were running. *Id.* Murphree died two days after the accident. *Id.*

[77] *Id.* at *3.

[78] *Id.*

[79] *Id.*

[80] *Id.* at *5-*6. For this one case, the court treated the immune employer like an insolvent party. The court used modified joint and several liability, as it is included in section 85-5-7(2), as a vehicle to redistribute about half of Wilburn Oil's uncollectible proportionate share of the damages to the remaining non-settling defendants. *See id.* at *5. But after *Mack Trucks*, Wilburn Oil would never have been apportioned fault, and its 39% share would have to be apportioned to Mack Trucks, Cummins and/or Murphree. This decision is unsettling because the court effectively reasons that the same jury that only apportioned 1% of fault collectively to the two defendants would in turn apportion 40% of fault (all of the employer's fault) to the same defendants and not one bit to the plaintiff simply because it does not have the option to apportion fault to the employer.

fault because it can not be held jointly and severally liable for damages at law due to its tort immunity provided by workers' compensation law and retained in section 85-5-7(5).[81]

But, an insolvent party is apportioned fault, and later those damages attributable to it are redistributed so the plaintiff will recover 50% of its recoverable damages under section 85-5-7(2).[82] Similarly, absent settling tortfeasors who are released from further liability are apportioned fault.[83] Therefore, apportionment to an employer should not hinge on responsibility to pay its apportioned share of a damages award. Instead, the court should look to the language of section 85-5-7 for guidance. But unlike *Hunter* and other sources,[84] neither *Accu-Fab* nor *Mack Trucks* considered the actual language of section 85-5-7 before rendering on the issue of apportionment to employers. Although disregarded in *Mack Trucks*, the ultimate statutory issue to be resolved is: Whether an immune employer is a "party," "person" or "joint tortfeasor" under section 85-5-7(2), (3) and (7).[85]

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[81] *Mack Trucks*, 2001 WL 171330, at *4-*5. *See* MISS. CODE ANN. § 85-5-7(5) (1999) ("Nothing in this section shall eliminate or diminish any defenses or immunities which currently exist, except as expressly noted herein."). The court concludes "immune actors should not be considered in the allocation of fault" because (1) section 85-5-7(7) "leaves for interpretation the question which if any non-parties may be considered for allocation of fault," and (2) employers are not specifically referenced in section 85-5-7. *Mack Trucks*, 2001 WL 171330, at *5. The court also mentions that employers were not included in the apportionment process before 1989, but before then, Mississippi did not have an apportionment statute (§ 85-5-7). *Id.* Also, the court did not cite one case in the portions of the opinion dealing with apportionment. *Id.*

[82] For a Mississippi case in which an insolvent party was apportioned fault, see Narkeeta Timber Co. v. Jenkins, 777 So. 2d 39 (Miss. 2000).

[83] The percentage of a damage award apportioned to an absent settling tortfeasor is cancelled out through proportionate reduction. *See supra* notes 51-60 and accompanying text.

[84] *See, e.g.*, *Hunter*, 729 So. 2d at 1272-75; Green & Graves, *supra* note 1, at 662-70; Williams, *supra* note 1, at 153-58.

[85] To read the statutory sections, see *supra* note 32. An employer contributing to the injuries of its plaintiff-employee is included in the *Hunter* definition of "party," which is "any participant to an occurrence which gives rise to a lawsuit, and not merely parties to a particular lawsuit or trial." *See supra* notes 40, 62-63 and accompanying text. The employer contributing to the injuries of the plaintiff-employee is included in the § 85-5-7(2)-(3) definition of "person" which is simply someone who has caused damages. *See supra* note 32. An employer contributing

VI. PROPOSED SOLUTION TO APPORTIONMENT OF FAULT TO IMMUNE EMPLOYERS

A. Introduction

Initially, it should be noted that there is no clear majority on the issue of apportionment of fault to immune employers.[86] But if the employer is not apportioned, Mississippi plaintiffs and defendants will suffer alike.

An employer's tort immunity is a misnomer, for it is not without liability.[87] In fact, under workers' compensation, employers are liable regardless of fault every time one of its employees is injured in the scope of employment.[88] Provided that negligence, if any, contributing to an employee's injury is shared completely between the employee and his employer, workers' compensation is the employee's only avenue for recovery. The Mississippi Legislature implicitly acknowledges that compensation, in these circumstances, is sufficient, or else it would provide for additional recovery.

But when the negligence contributing to the employee's injuries is shared between the employee, his employer *and* a third party, the employee has the right to sue for damages.[89]

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to the injuries of its plaintiff-employee is included in the modern definition of "joint tortfeasor" which includes those persons who have contributed to a plaintiff's injuries. *See supra* notes 25-31 and accompanying text.

[86] *See generally* RESTATEMENT (THIRD) OF TORTS: APPORTIONMENT OF LIABILITY § 17 (2000) (listing all jurisdictions who permit apportionment of fault to employers and the relevant legal authorities). Nineteen states, including Mississippi, do not apportion (Alaska, Connecticut, Georgia, Indiana, Iowa, Kentucky, Louisiana, Nevada, New Jersey, Massachusetts, Mississippi, Missouri, Montana, Ohio, Oregon, Pennsylvania, Tennessee, Texas, Washington). *Id.* Nineteen jurisdictions do apportion (Arizona, Arkansas, California, Colorado, Florida, Hawaii, Idaho, Illinois, Kansas, Michigan, Minnesota, New Mexico, New York, North Dakota, Oklahoma, Utah, West Virginia, Wisconsin, Wyoming). *Id.* Three jurisdictions are undecided (Nebraska, New Hampshire, Vermont). *Id.* And, ten more jurisdictions probably would not apportion (Alabama, Delaware, D.C., Maine, Maryland, North Carolina, Rhode Island, South Carolina, South Dakota, Virginia). *Id.* No clear patterns, like retention of joint and several liability or abolition of several liability, are manifest in the choices made.

[87] *See supra* notes 11-12 and accompanying text.

[88] *See supra* notes 10-11 and accompanying text.

[89] *See supra* note 13 and accompanying text.

Compensation payments are often inadequate to "compensate" the employee for his injuries, that is to say damages at law exceed compensation.[90] So, to ensure the plaintiff does not obtain a double recovery, the employer is reimbursed for compensation paid.[91] As a matter of policy, employers should not pay for the carelessness of others. However, employers recover first from any damages even if they contributed substantially to the employee's injuries.

What policy justifications entitle an employer to priority reimbursement of compensation paid when its own carelessness has contributed to the employee's injury? At law, a jury determines a plaintiff's damages by determining the entire amount it believes the plaintiff has suffered without regard to the parties at trial.[92] Then, the jury must also apportion all 100% of the fault to those parties it can consider.[93] The respective fault of all negligent contributors (including absent immune employers) not considered during the apportionment process is redistributed to less culpable parties at the whim of the jury.[94] Conceding that it prevents double recovery by the plaintiff, the employer's subrogation right does not, however, prevent payment of double damages by the defendants (or, reduced recovery for the plaintiff) if they consequently bear a substantial burden of the fault attributable but not appor-

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[90] Theodore F. Haas, *On Reintegrating Workers' Compensation and Employers' Liability,* 21 GA. L. REV. 843, 844 (1987).

[91] *See supra* notes 14-18 and accompanying text.

[92] Consider a jury instruction from a Mississippi case, "[The jury] shall proceed as follows: (1) Determine the total damages, if any, the Plaintiff sustained as a direct proximate result of the accident, then (2) Determine the percentage or degree of negligence of the respective parties (combined percentages must equal 100%)." McBride v. Chevron U.S.A., 673 So. 2d 372, 378 (Miss. 1996).

[93] *Id.*

[94] *See supra* notes 8, 62-63, 91 and accompanying text.

tioned to the employer.[95] In the end, under this system, allocation of percentages of fault becomes irrational.

The shared goal of workers' compensation and personal injury suits at law is to make the injured employee/plaintiff whole . . . not more than or less than whole. Full subrogation accomplishes this goal to the benefit of the employers and the detriment of the parties to the subsequent lawsuit. Wrongdoers make right by paying for their carelessness. At law, defendants account for their negligence. "At compensation," however, employers account without regard to their own negligence. The tension between compensation and damages at law manifests itself in the awkward device of subrogation when plaintiffs and defendants are apportioned fault for negligence properly attributable to the employer. Somewhat mechanically, under these circumstances, employers are fully reimbursed regardless of fault. Consider a hypothetical: If an employee loses his arm, for example, in an on the job injury for which the employer is mostly to blame and compensation is $30,000, but recoverable damages are $50,000, what should be the plaintiff's recovery? One hundred percent of fault will have been apportioned between the plaintiff and defendant. Applying subrogation, the plaintiff would receive only $20,000 (in addition to compensation already paid—$30,000—but oftentimes already spent on hospital bills), while the employer would be fully reimbursed $30,000 for compensation paid. Heretofore unaccountable employers should be made to pay

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[95] The Uniform Comparative Fault Act (UCFA) acknowledges the inherent problems. *See* UNIF. COMPARATIVE FAULT ACT § 6, 12 U.L.A. 147 (1996) ("This casting of the whole loss on the tort defendant may be unfair and greatly in need of legislative adjustment."). The UCFA inappropriately assumes the jury would cast the whole loss on the defendant. The Mississippi Supreme court shares the same view as the UCFA. *See Mack Trucks*, 2001 WL 171330, at *5 (imputing negligence apportioned to employer to non-settling defendants without disrupting percentage apportioned to plaintiff). However, the jury is equally likely to cast some portion of that loss (the fault attributable but not apportioned to the employer) on the plaintiff. For example, to conclude that the same jury that apportioned only 1% of fault collectively between two defendants, in *Mack Trucks*, would apportion 40% to the them simply because it could not apportion fault to the employer does not comport with common sense. *See supra* note 78-79 and accompanying text.

their injured employee a sum fixed by their own percentage of negligence contributing to the injuries.

"Any method of apportioning fault which ignores the respective percentages of responsibility, without a significant consideration justifying the displacement, is inconsistent with pure comparative negligence principles."[96] The basic goal of several liability, that defendants pay only their share of damages in direct proportion to their negligence, is unattainable if the employer is not apportioned fault.[97] Mississippi is a several liability jurisdiction. Joint and several liability is an afterthought, applicable only when there are insolvent non-settling tortfeasors. The principles of comparative negligence and several liability are in direct conflict with the employer's tort immunity and its subsequent right of subrogation.

To clarify, apportioning fault to the employer will be a start in the right direction. But, the employer's right to full priority reimbursement needs changing to achieve consistent, predictable and fair results under section 85-5-7.

B. Proposed Solution Consistent with Existing Law: § 71-3-71 and § 85-5-7

After weighing the same considerations in a decision to apportion fault to an absent settling tortfeasor, the defendants *should* have the option to submit the employer to the jury for apportionment of fault.[98] If apportioned, the employer who is

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[96] Williams, *supra* note 1, at 151.

[97] *See supra* notes 7-10, 62-63 and accompanying text. Under pure comparative negligence, plaintiff's recovery is reduced by the extent of his fault. Under modified forms, the same is true except that if a plaintiff is more than 49% or 50% at fault he recovers nothing. Under contributory negligence, if the plaintiff is 0.1% at fault he does not recover, and defendants pay either their percentage of fault, under several liability, or potentially in excess of their fault, under joint and several liability. *But under section 71-3-71*, an employer always recovers as much of a judgment as reimburses him for compensation paid regardless of fault. This simply does not equate with any other imaginable system of recovery.

[98] *See supra* text p. 836. The plaintiff could not effect this decision because it is not in a position to allege that his employer was negligent because of the employer's tort immunity. *See supra* note 41 and accompanying text.

Regarding notice of defendant's intention to consider the employer's fault, either of two options would work. The plaintiff could be considered constructively

immune from tort liability should be treated like an insolvent tortfeasor.[99] Its proportionate share would be redistributed to the defendants, and not the plaintiff, in order to recover 50% of recoverable damages, as directed by section 85-5-7(2).[100] In order to implement this method, no exceptions to case law or statutory interpretations of section 85-5-7 are required.[101] Double recovery by the plaintiff is prevented because the employer's subrogation right, under section 71-3-71, is left untouched. Payment of double damages is lessened because defendants do not bear the entire burden of the employer's fault. The injured employee's recovery is not reduced by fault apportioned to him yet attributable to the employer. And most importantly, the principles of several liability (liability in direct proportion to fault) are advanced.

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notified when he sues third parties for injuries occurring in the scope of employment. It would always be in the plaintiff's best interest to shift as much blame from his employer to the actual parties in the lawsuit. Alternatively, the defendants could be required to allege an employer's contributory negligence in its answer, or otherwise notify the plaintiff by motion during pleading.

If an employer is apportioned fault, the plaintiff's recovery would not be diminished at all because the immune employer's share of fault would be redistributed to defendants, just as it would for a partially negligent insolvent party. A defendant would choose not to apportion fault to the employer if, for example, his own relative degree of fault is small and the employer's is substantial. In *Mack Trucks*, the defendants probably should not have asked the judge to submit the employer for apportionment. *See generally* RESTATEMENT (THIRD) OF TORTS: APPORTIONMENT OF LIABILITY § B19 cmt. g (2000).

[99] This provision would give effect to the statutory provision explicitly preserving the employer's tort immunity. MISS. CODE ANN. § 85-5-7(8) (1999).

[100] *See supra* notes 32, 39, 44 and accompanying text.

[101] An immune employer should qualify as a person, party and joint tortfeasor within the meaning of sections 85-5-7(2), (3), (7). *See supra* notes 24, 31-32 and accompanying text. The court in *Mack Trucks* and *Accu-Fab* did not rely on section 71-3-71 nor did it reason that immune employers fell outside the broad *Hunter* definition of parties to be apportioned fault. *See supra* notes 29, 32, 40, 62-63 and accompanying text. Plus, the same policies in favor of apportioning absent settling tortfeasors apply to apportionment of immune-employers. *See supra* notes 62-63 and accompanying text. And, importantly, it would be otherwise impossible to determine the liability of a defendant in direct proportion to his percentage of fault without considering the fault of the employer. *See supra* notes 6-9, 29, 31 and accompanying text. In several liability jurisdictions, at least one party would bear a burden in excess of its true proportionate liability if the relative faults of all negligent actors were not considered. *See supra* notes 8, 62-63, 85, 92, 94 and accompanying text.

In fact, under this method, the defendants in *Mack Trucks* would be jointly and severally liable for the exact same $294,000.[102] This change would have a different substantive effect in cases in which 50% of the recoverable damages (the portion of the damage award for which non-settling tortfeasors are jointly and severally liable) is apportioned to non-settling tortfeasors and is paid by them. Consider such a hypothetical in which the employer (ER) is apportioned: P sues A and B. The jury finds damages in the amount of $100,000, and apportions fault P-40%, A-20%, B-20% and ER-20%. The recoverable damages, after reducing P's fault, would be $60,000, so A and B would be jointly and severally liable for half that, or $30,000. In this instance, A and B would not have to pay for ER's fault. A different result would follow if the jury apportioned fault P-40%, A-10%, B-10% and ER-40%. A and B would still be jointly and severally liable for $30,000. If A and B both tendered $10,000, they would have to account for the remaining $10,000 which is part of the fault apportioned to the employer. Accordingly, defendants would pay part of the employer's fault only in cases in which its consideration is necessary under section 85-5-7(2) (modified joint and several liability provision) for the plaintiff to recover 50% of his recoverable damages.

C. Proposed Solution Requiring Statutory Change by Mississippi Legislature

In order to further accommodate this proposal's adherence to principles of several liability, the reimbursement/subrogation provision, section 71-3-71, needs to be changed. This article proposes reducing the employer's reimbursement amount (which equals compensation paid) by its

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[102] *See supra* notes 50, 79-80 and accompanying text. But, in a case like *Mack Trucks*, where the damages are likely to be high and the employer's fault is substantial, the defendants would not let the jury apportion the employer's fault. *See supra* text p. 836. In *Mack Trucks*, and under this rule, the plaintiff benefits from apportionment of fault to its employer. Had the jury in *Mack Trucks* not apportioned fault to the employer, common sense dictates that the same jury would not have redistributed much if any of the 39% attributed to the employer to the defendants it initially found only 1% at fault combined.

proportionate percentage of fault for damages in a suit at law.[103] Consider a hypothetical: ER tenders $20,000 in compensation, but is apportioned 50% fault in a suit at law with $50,000 damages. The $20,000 reimbursement would be cut by 50% (percentage of negligence) to $10,000, the other $10,000 remaining in the hands of the employee. The employer's right to reimbursement would be affected by its relative degree of fault, which is the existing standard of recovery and liability for plaintiffs and defendants in all comparative negligence jurisdictions. Furthermore, the employer would have incentive to cease any negligent behavior as well as implement more safeguards, and the plaintiff's recovery would more resemble his actual damages because of the current inadequate remedies under workers' compensation.

VII. CONCLUSION

In 1999, *Estate of Hunter v. General Motors Corp.* breathed life into section 85-5-7 of the Mississippi Code. Now, there is room for gamesmanship and good lawyering in section 85-5-7, for the jury *may* consider the fault of absent settling tortfeasors. The non-settling defendant stands to gain if he decides correctly to whom the jury should apportion fault, and consequently, in what manner the damage award will be reduced by the settlement—either pro-tanto or proportionate share reduction.

Within two years, the Mississippi Supreme Court retreated from *Hunter* without apparent justification. Without using

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[103] A more radical change is not without justification. Retaining apportionment of employers, prevention of double recovery (a noted policy rule) *and double damages* (a several liability policy) could easily be attained if courts treat compensation paid as a settlement between the employee and its employer in release of tort liability. In that case, the pro-tanto or proportion reduction would apply depending on whether the defendants sought to have the employer's fault apportioned. But, the provisions of section 71-3-71 entitling employers to reimbursement/subrogation would have to be thrown out or else the plaintiff's recovery would be reduced too much. Such a course would not only render more uniform the treatment of all Mississippi tortfeasors, but also would allow a logical adherence to strong state principles embedded in its long tradition of pure comparative negligence. But it must be noted that an employer's subrogation right is a clear, powerful and well-established statutory grant from the Mississippi Legislature.

the language of section 85-5-7 as a guide, the court concluded that an employer with tort immunity will not be apportioned fault in suits brought by its employee against third party tortfeasors. As a result, the employer is the only party whose recovery is not based on fault under section 85-5-7 and section 71-3-71. The employer even recovers in spite of fault. This article proposes that fault should be apportioned to an immune employer and then redistributed to the defendants under section 85-5-7(2) as if it were an insolvent tortfeasor. Further, the employer's claim for reimbursement should be reduced proportionately by his percentage of fault. Accordingly, the employer's recovery decreases as his contributory negligence increases and the injured employee is more accurately and justly "compensated" for his injuries.

Robert B. Ireland, III

RECENT DECISION

Constitutional Law—Fourth Amendment—Primary Purpose of Checkpoint Programs Must Be Distinguishable from Government's General Interest in Crime Control

I. FACTS

In August 1998, the Indianapolis Police Department began the operation of vehicle checkpoints on Indianapolis roads, with the primary goal of discovering and interrupting the flow of illegal drugs through Indianapolis.[1] Drivers stopped at the checkpoints were notified of the purpose behind the stop and were asked to produce their driver's license and registration while a narcotics-detection dog was led around each stopped vehicle.[2] Vehicles were only to be searched by consent or based on individualized suspicion by the officers.[3] James

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[1] City of Indianapolis v. Edmond, 531 U.S. 32, 34 (2000). Indianapolis police conducted six roadblocks between August and November of 1998. *Edmond*, 531 U.S. at 34. Road signs identified the roadblock as a drug checkpoint, and officers identified themselves to motorists as being part of a drug checkpoint. *Id.* at 41. Officers at the checkpoint stopped 1161 vehicles and arrested 104 motorists during the course of the program. *Id.* at 35. The program garnered fifty-five drug-related arrests and forty-nine arrests for non-drug offenses, an overall arrest rate of approximately nine percent. *Id.*

[2] *Id.* at 35. The procedure followed during each checkpoint operation was based on written directives from the chief of police. *Id.* The officer notifying the motorist of the purpose of the stop would also look into the interior of the car and check for any signs of impairment of the driver. *Id.*

[3] *Id.* The instructions maintained that officers should conduct each stop in a

Edmond and Joell Palmer filed a lawsuit against the City of Indianapolis in the United States District Court for the Southern District of Indiana claiming the city violated the Fourth Amendment of the United States Constitution by seizing motorists without probable cause.[4]

The district court entered judgment for the City of Indianapolis.[5] The United States Court of Appeals for the Seventh Circuit reversed the lower court's ruling and held that the checkpoints were unconstitutional.[6] The United States Supreme Court granted certiorari and held: affirmed.[7] When law enforcement agencies use checkpoints as a tool in general crime control, they violate Fourth Amendment protections against unreasonable searches and seizures.[8]

II. RELATED LAW

The Fourth Amendment to the United States Constitution protects citizens from unreasonable government searches and seizures.[9] With the advent of the automobile at the beginning

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uniform manner until the necessary level of suspicion of illegal activity was reached to begin a search. *Id.* The total time of each seizure, barring the need for a search, was five minutes or less. *Id.*

[4] *Id.* at 36. Edmond and Palmer also claimed the seizures violated the search and seizure provision of the Indiana Constitution. *Id.* The lawsuit was filed on behalf of the entire class of motorists stopped at the checkpoints and those motorists who would be stopped in the future. *Id.* The respondents requested an injunction ordering the Indianapolis Police to cease operation of the checkpoints, in addition to damages and attorney's fees. *Id.*

[5] *Id.* The district court found that the checkpoint program did not contravene the protections from seizures required by the Fourth Amendment. *Id.* The district court denied injunctive relief for the plaintiffs, but did agree to class certification. *Id.*

[6] *Edmond*, 531 U.S. at 36. The Seventh Circuit, in a divided opinion, reversed the district court's determination that the roadblocks did not violate the Fourth Amendment. *Id.* The appellate court denied a rehearing on the matter. *Id.*

[7] *Id.* The Court decided *Edmond* with a majority of six to three Justices. *Id.* at 33.

[8] *Id.* at 48. The Court noted that the state stipulated the checkpoints were set up for the purpose of narcotic interdiction. *Id.* at 40-42. This purpose, according to the Court, was too closely related to the purpose of crime control in general to be distinguishable. *Id.* 46-47. Because of this stipulation, the Court did not express an opinion as to the legality of roadblock seizures organized for the primary purpose of license or sobriety checks, with a secondary purpose of detecting the presence of illegal drugs. *Id.* at 47 n.2.

[9] U.S. CONST. amend. IV (stating that "The right of the people to be se-

of the twentieth century came new questions about how to apply the privacy rights guaranteed by the Fourth Amendment to this new mode of transportation.[10] This section explores the development of this doctrine as it applies to automobile searches and seizures.[11]

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cure . . . against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause . . . ."). *See* Michael E. Brewer, Comment, Chandler v. Miller: *No Turning Back From a Fourth Amendment Reasonableness Analysis*, 75 DENV. U. L. REV. 275, 276 (1997) (stating that "[h]istorically the Court considered searches conducted without warrants issued upon probable cause unreasonable per se"). Over the last century, the Supreme Court has been divided into two groups over the central thought of the Fourth Amendment, with each group deriving different meanings from the Reasonableness and Warrant Clauses of the amendment. Tracey Maclin, *The Central Meaning of the Fourth Amendment*, 35 WM. & MARY L. REV. 197, 202-03 (1993); *see* United States v. Rabinowitz, 339 U.S. 56, 60 (1950) (recognizing some warrantless searches are reasonable if subsequent arrest is legal), *overruled in part by* Chimel v. California, 395 U.S. 752, 768 (1969). *But see* Chimel, 395 U.S. at 761 (1969) (noting that U.S. Constitution "requires a magistrate to pass on the desires of the police" before searches of homes can take place); *Rabinowitz*, 339 U.S. at 70-71 (Frankfurter, J., dissenting) (holding searches without warrants are not constitutional simply because arrest is legal). *See generally* Thomas Y. Davies, *Recovering the Original Fourth Amendment*, 98 MICH. L. REV. 547, 693-723 (1999) (discussing how neither construction of Fourth Amendment is true progeny of Framers' intent).

[10] David A. Harris, *Car Wars: The Fourth Amendment's Death on the Highway*, 66 GEO. WASH. L. REV. 556, 565-66 (1998). The Supreme Court first articulated an "automobile exception" to the Fourth Amendment's warrant requirement in 1925. Carroll v. United States, 267 U.S. 132, 153 (1925); *see* Leading Cases, *Search and Seizure – Automobile Exception – Search of Passengers' Belongings*, 113 HARV. L. REV. 255, 255 n.6 (1999) (observing that automobile exception can be traced to *Carroll*). In *Carroll*, the Court noted that Fourth Amendment protections had previously been construed less strenuously against searches and seizures of boats, wagons and ships as against those of stores or houses. *Carroll*, 267 U.S. at 153; *see* Wyoming v. Houghton, 526 U.S. 295, 302 (1999) (holding that when probable cause exists police may search entire vehicle without need of individualized suspicion of contraband in each compartment); United States v. Ross, 456 U.S. 798, 809 (1982) (holding *Carroll* exception extends to searches of vehicles supported by probable cause); Hester v. United States, 265 U.S. 57, 59 (1924) (noting special Fourth Amendment protections extend only to "persons, houses, papers and effects"). *See generally* Sara L. Shaeffer, Note, *Another Dent in Our Fourth Amendment Rights: The Supreme Court's Precarious Extension of the Automobile Exception in* Wyoming v. Houghton, 45 S.D. L. REV. 422, 450-51 (1999-2000) (arguing that Court's "preposterous holding" in *Houghton* places no limits on ability of police to conduct searches of vehicles).

[11] For a grim view of a future where the ability of law enforcement to raise checkpoints is unfettered, see Suzanne Graves, Notes, *Checkpoints and the Fourth*

A. Constitutionality of Checkpoints

The Supreme Court addressed the issue of checkpoints operated by the Border Patrol near the Mexican border in *United States v. Martinez-Fuerte*.[12] In *Martinez-Fuerte*, the drivers of vehicles stopped at a permanent immigration checkpoint in California claimed that the operation of the checkpoint violated their Fourth Amendment rights.[13] The Court held that brief stops for questioning at permanent roadblocks were constitutional, and were not required to be authorized by search warrants.[14] The Court recognized that the State's in-

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Amendment: Saving Grace or Constitutional Martyr?, 32 CONN. L. REV. 1487, 1517-19 (2000).

[12] 428 U.S. 543 (1976).

[13] *Martinez-Fuerte*, 428 U.S. at 545. The checkpoint was located on Interstate 5 between San Diego and Los Angeles. *Id.* Both petitioners were arrested on illegal immigration-related charges. *Id.* The Border Patrol used permanent checkpoints, temporary roadblocks and roving patrols to combat illegal immigration. *Id.* at 552. *See generally* Shannon S. Schultz, Note, Edmond v. Goldsmith: *Are Roadblocks Used to Catch Drug Offenders Constitutional?*, 84 MARQ. L. REV. 571, 573 (2000) (reviewing constitutional history of checkpoints).

[14] *Martinez-Fuerte*, 428 U.S. at 566. The Court acknowledged that checkpoint stops were considered Fourth Amendment seizures. *Id.* at 556. The Court applied a balancing test to determine whether or not the seizures were reasonable, weighing the state's interest in controlling immigration against the rights of the individual. *Id.* at 555; *see* United States v. Ramsey, 431 U.S. 606, 618 (1977) (holding that law enforcement has more authority in making stops on international border than within interior of country); United States v. Brignoni-Ponce, 422 U.S. 873, 881 (1975) (holding that brief stops with probable cause can, in appropriate circumstances, be constitutional due to difficulty in patrolling border areas); Terry v. Ohio, 392 U.S. 1, 20-21 (1968) (explaining balancing test between governmental and individual interests in Fourth Amendment searches). The Court noted that individualized suspicion is usually required before an officer can stop a motorist, but the Court concluded that "the Fourth Amendment imposes no irreducible requirement of such suspicion." *Martinez-Fuerte*, 428 U.S. at 560-61; *see* Colonnade Catering Corp. v. United States, 397 U.S. 72, 77 (1970) (upholding Congress' authority to allow warrantless searches of businesses that serve alcohol); Camara v. Mun. Court, 387 U.S. 523, 538 (1967) (holding that building inspectors could search building with "area" warrant and without specific knowledge of particular code violations within building).

The Court has allowed suspicionless searches and seizures in other areas where officials and administrators are able to demonstrate a need for searches that goes beyond the normal need of government and employers. *Cf.* Vernonia Sch. Dist. 47J v. Acton, 515 U.S. 646, 665 (1995) (allowing random testing of athletes); Skinner v. Ry. Labor Executives' Ass'n, 489 U.S. 602, 634 (1989) (allow-

terest in combating the influx of illegal aliens justified the interference with Fourth Amendment freedoms.[15] The Court reasoned that brief stops at checkpoints constituted only an inconsequential intrusion on Fourth Amendment interests.[16]

B. *Limiting the Ability of Law Enforcement to Stop Vehicles*

In *Delaware v. Prouse*,[17] the Court determined whether discretionary stops by individual patrolmen were constitutional.[18] In *Prouse*, a patrolman pulled over a driver to check his license and registration, without having observed a traffic violation and without any suspicion of illegal activity.[19] The

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ing drug and alcohol tests for certain railway employees); Michigan v. Tyler, 436 U.S. 499, 511 (1978) (allowing inspection of fire-damaged building to determine cause of blaze).

[15] *Martinez-Fuerte*, 428 U.S. at 556. An estimated 85% of illegal immigrants arrive from Mexico. *Id.* at 551. *See* Almeida-Sanchez v. United States, 413 U.S. 266, 293 (1973) (White, J., dissenting) (describing difficulties in maintaining border between United States and Mexico). Economic opportunity draws most of the immigrants to the United States. *Martinez-Fuerte*, 428 U.S. at 551; *see* United States v. Baca, 368 F. Supp. 398, 402 (S.D. Cal. 1973) (noting that average daily wage in Mexicali and Tijauna is $3.40).

[16] *Martinez-Fuerte*, 428 U.S. at 557. The Court pointed out that one's privacy expectation is "significantly different" in a car as opposed to the expectation in one's home. *Id.* at 561; *see* United States v. Ortiz, 422 U.S. 891, 896 n.2 (1975) (noting difference between search of home and office on one hand and car on other); Cardwell v. Lewis, 417 U.S. 583, 590 (1974) (explaining that one's expectation of privacy is less in car than home because of car's use for transportation purposes and because it does not serve as "repository of personal effects"); Chambers v. Maroney, 399 U.S. 42, 48 (1970) (noting Court "has long distinguished" between searches of car and home). The Court also determined the location of the checkpoint was reasonable and effective, as confirmed by the high number of arrests made at the roadblock. *Martinez-Fuerte*, 428 U.S. at 562 n.15.

[17] 440 U.S. 648 (1979).

[18] *Prouse*, 440 U.S. at 650. In addition to Fourth Amendment claims, the Delaware Supreme Court below declared that the discretionary stop violated the Delaware Constitution. *Id.* at 651-52. *See* DEL. CONST. art. I, § 6 (stating no searches are legal unless done with warrant or with "probable cause supported by oath or affirmation"). The U.S. Supreme Court was urged to refuse the appeal on the grounds that the decision below was "based on an independent and adequate state ground." *Prouse*, 440 U.S. at 652. The Court refused to do so and noted that the protections granted by the Delaware Constitution in this area, according to the Delaware Supreme Court, were at least as broad as those allowed by the Fourth Amendment. *Id.*; *see* State v. Prouse, 382 A.2d 1359, 1362 (Del. 1978) (holding search and seizure provision of Delaware Constitution is "substantially similar" to Fourth Amendment).

[19] *Prouse*, 440 U.S. at 650. The patrolman testified that he was not operating

Court held that unless definite suspicion exists that a driver has committed an unlawful act, stopping a vehicle and detaining the driver for the purpose of checking his license and registration violates the Fourth Amendment.[20] The Court reasoned that the danger of an abuse of discretion by individual patrolmen was greater than any marginal benefit the stops produced on behalf of roadway safety.[21]

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under any guidelines or standards when he made the registration spot check. *Id.* The patrolman smelled marijuana smoke as he approached the vehicle and saw marijuana on the car floor. *Id.* The respondent was arrested for illegal possession of a controlled substance. *Id.*

[20] *Id.* at 663. The Court reiterated the balancing test mentioned in *Martinez-Fuerte*. *Id.* at 654. The Court held that law enforcement agencies must use some safeguards so that limits are placed on the discretion of officers in the field. *Id.* at 654-55. The Court noted that individuals traveling by automobile do not automatically forfeit all privacy expectations. *Id.* at 662; *see* Adams v. Williams, 407 U.S. 143, 146 (1972) (holding that police officers making investigatory stops can search motorist without probable cause only for defensive purposes); *see also* Marshall v. Barlow's, Inc., 436 U.S. 307, 324 (1978) (holding warrantless inspections under Occupational Safety and Health Act unconstitutional); See v. City of Seattle, 387 U.S. 541, 546 (1967) (holding business owner cannot be prosecuted for refusing to allow fire inspector access to business without warrant). The Court compared the stops at issue in this case to the unconstitutional Border Patrol stops in *Brignoni-Ponce*. *Prouse*, 440 U.S. at 657. The Court held that, for Fourth Amendment purposes, no significant differences existed between the two types of stops. *Id.* Both stops involved pulling vehicles over without probable cause, both were inconvenient to the motorist, and both may have generated a similar level of anxiety in the driver and passengers. *Id.*

[21] *Prouse*, 440 U.S. at 661. The Court discounted the State's argument that the stops were reasonable because they served the important state interest of maintaining public safety. *Id.* at 658. The Court agreed with the proposition that public roads need safety management, but reasoned that licensing, registration, minimum insurance requirements, and inspection requirements would keep dangerous drivers off the road more effectively than stopping drivers who had committed no noticeable violation. *Id.*; *see* DEL. CODE ANN. tit. 21, § 2701 (1999) (providing for licensing of drivers); DEL. CODE ANN. tit. 21, §2143(a) (1999) (providing for vehicle inspections); DEL. CODE ANN. tit. 21, § 2118 (1999) (mandating automobile insurance as requisite for registration of vehicle). The Court decided that by allowing patrolmen to conduct discretionary spot checks, the State of Delaware essentially gave each officer unbridled authority to pull over whomever they pleased. *Prouse*, 440 U.S. at 663. The Court feared that subjecting every motorist to the unrestrained discretion of law enforcement officers would open the door to an invasion of drivers' Fourth Amendment rights. *Id.*; *see* Terry v. Ohio, 392 U.S. 1, 22 (1968) (explaining that motorists' constitutional rights would be trampled upon based on nothing more than "inarticulate hunches" of officers).

The Court would revisit the issue of law enforcement discretion in making traffic stops in 1996. *Whren v.United States*, 517 U.S. 806, 810 (1996) (noting that

C. More Areas for Legal Checkpoints

The Supreme Court validated another situation in which police roadblocks may be constitutionally utilized in *Michigan Department of State Police v. Sitz*.[22] In *Sitz*, motorists licensed in the State of Michigan filed a complaint against the State Police alleging that a checkpoint conducted with the purpose of combating drunken driving contravenes the Fourth Amendment's protections against unreasonable searches and seizures.[23] The Court held that the Constitution does not pro-

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police officers can generally make valid traffic stops once violations have been observed). In *Whren*, the Supreme Court was asked if improper ulterior motives could invalidate objectively justifiable police conduct. *Whren*, 517 U.S. at 810. The petitioners in *Whren* were arrested for various drug violations after being pulled over by police for failing to signal a turn at a stop sign. *Id.* at 808-09. The petitioners argued the police were not at all interested in issuing a traffic warning, but instead used the traffic violation as an excuse to approach the vehicle and look for drugs. *Id.* at 809. The petitioners cited several cases supporting their contention that police officer's motives must be pure in order to make a lawful stop. *Id.* at 811; *cf.* Florida v. Wells, 495 U.S. 1, 4 (1990) (stating "an inventory search must not be a ruse for general rummaging in order to discover incriminating evidence"); New York v. Burger, 482 U.S. 691, 716 (1987) (holding inspection was legal because it did not appear to be pretext for gathering evidence of other unlawful activity); Colorado v. Bertine, 479 U.S. 367, 372 (1987) (indicating that search was legal because no showing had been made that police had acted in bad faith). The Court rejected this argument and held that the traffic stop was reasonable, since objective justifications existed to support the legality of the stop. *Whren*, 517 U.S. at 819; *see* Bond v. United States, 529 U.S. 334, 338 (2000) (holding subjective intentions of officer conducting justifiable tactile examination of bag irrelevant); United States v. Villamonte-Marquez, 462 U.S. 579, 584 n.3 (1983) (dismissing idea that ulterior motive can strip customs agents of objective justification for searches); United States v. Robinson, 414 U.S. 218, 221 n.1 (1973) (holding traffic-violation arrest would not be invalidated because of pretextual motives). *See generally* Kenneth Gavise, Note, *Making the Best of* "Whren": *The Problems with Pretextual Traffic Stops and the Need for Restraint*, 50 FLA. L. REV. 385, 403 (1998) (arguing *Whren* unnecessarily gave police officers tremendous discretion to detain motorists); Matthew J. Saly, Whren v. United States: *Buckel-Up and Hold on Tight Because the Constitution Won't Protect You*, 28 PAC. L. J. 595, 616-18 (1997) (arguing that ability of law enforcement to stop motorists for any traffic violation gives police unlimited discretion).

[22] 496 U.S. 444 (1990).

[23] *Sitz*, 496 U.S. at 448. The Michigan State Police operated only one sobriety checkpoint. *Id.* Out of one hundred twenty-six vehicles stopped, two drunken driving arrests were made. *Id.* In addition to the Fourth Amendment, the respondents alleged the checkpoint violated the Michigan Constitution. *Id.*; *see* MICH.

hibit law enforcement's use of sobriety checkpoints.[24] The Court reasoned that the severity of the damage caused by drunken driving is a significant problem in Michigan, and it is worth the slight burden the checkpoints cause to the law-abiding drivers.[25]

CONST. art. I, § 11 (stating "every person shall be secure from unreasonable searches and seizures").

[24] *Sitz*, 496 U.S. at 455. The respondents argued that an analysis of the constitutionality of a checkpoint must begin with individualized suspicion as a basis for a legal stop. *Id.* at 449; *see* Nat'l Treasury Employees Union v. Von Rabb, 489 U.S. 656, 665-66 (1989) (holding that individual suspicion might be required in situations where intrusion serves special government needs). *See generally* Recent Cases, *Constitutional Law—Fourth Amendment—Seventh Circuit Holds That Drug Interdiction Roadblocks Violate the Fourth Amendment*, 113 HARV. L. REV. 828, 833 (2000) (explaining that focusing on special needs indirectly aids individual freedoms because courts are required "to articulate the non-law-enforcement 'special need' being served"). The Court rejected that argument and instead used a different balancing test to decide the constitutionality of the sobriety checkpoints. *Sitz*, 496 U.S. at 448-49; *see* Sitz v. Dept. of State Police, 429 N.W.2d 180, 182 (1988) (stating test involves "balancing the state's interest in preventing accidents caused by drunk drivers, the effectiveness of sobriety checkpoints in achieving that goal, and the level of intrusion on an individual's privacy caused by the checkpoints"); Brown v. Texas, 443 U.S. 47, 50-51 (1979) (holding that test consisted of "a weighing of the gravity of the public concerns served by the seizure, the degree to which the seizure advances the public interest, and the severity of the interference with individual liberty").

The Court noted that the sobriety checkpoint, except for the nature of the questions asked of motorists, was almost identical to the checkpoints upheld in *Martinez-Fuerte*. *Sitz*, 496 U.S. at 451-52. Each motorist was stopped an average of only twenty-five seconds. *Id.* at 448. The Court noted that the level of "fear and surprise", or subjective intrusion, generated in each motorist should be a factor in determining the constitutionality of the stop. *Id.* However, the "'fear and surprise' to be considered are not the natural fear of one who has been drinking over the prospect of being stopped . . . but, rather, the fear and surprise engendered in law-abiding motorists by the nature of the stop." *Id.* at 452. The Court decided that the presence of uniformed officers, while following guidelines, stopping each vehicle passing through the roadblock, alleviated much of the fear in drivers. *Id.*; *see* United States v. Ortiz, 442 U.S. 891, 894 (1975) (holding that checkpoint stops are far less intrusive than roving-patrol stops). *See generally* James C. English, Comment, *Sobriety Checkpoints Under State Constitutions: What Has Happened to* Sitz*?*, 59 U. PITT. L. REV. 453, 501-02 (1998) (arguing that states need to focus more on checkpoints and less on lowering legal blood alcohol content levels to combat drunk driving); Nadine Strossen, Michigan Department of State Police v. Sitz: *A Roadblock to Meaningful Judicial Enforcement of Constitutional Rights*, 42 HASTINGS L.J. 285, 288 (1991) (criticizing *Sitz* for relinquishing control of "meaningful judicial review of government measures that abridge the personal liberties protected by specific Bill of Rights guarantees").

[25] *Sitz*, 496 U.S. at 451. Drunk driving causes over 25,000 deaths, over one

III. *CITY OF INDIANAPOLIS V. EDMOND*

A. Opinion of the Court

In *City of Indianapolis v. Edmond*,[26] the Supreme Court held that stopping vehicles at checkpoints established for the main purpose of drug interdiction constituted an unreasonable seizure, as drug interdiction is indistinguishable from the City's general interest in crime control.[27]

The Court immediately noted that vehicle stops at roadblocks are seizures within the meaning of the Fourth Amendment.[28] The Court then addressed the issue of whether these checkpoint stops were unconstitutional searches and seizures.[29]

The Court explained that constitutional roadblock programs are normally accompanied by some quantum of individualized suspicion.[30] The Court acknowledged that in previous

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million personal injuries, and billions of dollars in damage each year. *Id.* Only 1.6 percent of the drivers passing though the checkpoint were arrested for drunken driving. *Id.* at 455. The Court ruled that, although that number may seem modest, it surpassed the one percent arrest rate of motorists who are stopped by patrolmen, and the percentage exceeded the arrest rate of .12 percent for the illegal aliens at the checkpoint at issue in *Martinez-Fuerte*. *Id.* The Court explained that the degree of intrusion and the short length of the stops were inconveniences to motorists, but were ultimately outweighed by the government's interest in roadway safety. *Id.*

[26] 531 U.S. 32 (2000).

[27] *Id.* at 48. Justice O'Connor delivered the opinion of the Court, in which Justices Stevens, Kennedy, Souter, Ginsburg and Breyer joined. *Id.* at 33. The Court explained that its ruling did not affect the validity of other types of checkpoints, such as those deemed constitutional in *Martinez-Fuerte* (checkpoint for immigration control) and *Sitz* (sobriety checkpoints). *Id.* at 47. The Court held that the constitutionality of these checkpoint programs still depends "on a balancing of the competing interests at stake and the effectiveness of the program." *Id.*

[28] *Id.* at 40. The Court asserted that walking a drug dog around the vehicle does not turn the seizure into a search. *Id.* The Court explained that an exterior sniff is much less invasive than a normal search, as entry into the vehicle is not required. *Id.*

[29] *Id.* at 41-42. The Court stressed that the checkpoints were organized with the purpose of detecting illegal narcotics. *Id.* at 41.

[30] *Id.* The Court noted that they were reluctant to recognize exceptions to the general rule that calls for individualized suspicion of wrongdoing. *Id.* at 43. The circumstances in which the Court allows suspicionless searches are "limited." *Id.*

decisions it has allowed checkpoints in which police officers seize vehicles without individualized suspicion of wrongdoing.[31] The Court noted, however, that in those previous instances in which the particularized suspicion requirement was suspended the primary purpose of the checkpoints was closely tailored to the specific problems of patrolling the border or maintaining safe highways.[32] The Court found that the purpose of drug interdiction was too closely related to the City's general interest in crime control, and that the checkpoints organized under this purpose required individualized suspicion in order to pass Fourth Amendment muster.[33]

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at 37.

[31] *Edmond*, 531 U.S. at 43. The Court conceded that the suspicion requirement is not "an 'irreducible' component of reasonableness." *Id.* at 37. The Court noted that certain types of searches and seizures have been upheld where the government has demonstrated "special needs." *Id.*

[32] *Id.* at 43. The *Martinez-Fuerte* decision reflected the country's longtime concern for maintaining the integrity of our national borders. *Id.* at 37-38. The Court noted that patrolling the border posed a formidable challenge to the authorities responsible, more so than the duties normally placed on law enforcement officials. *Id.* at 38. The sheer volume of automobiles that passed through the checkpoint made particularized study of each vehicle impossible. *Id.* The Court defended the *Sitz* decision by stating that drunken driving was an immediate hazard to public safety, and "an obvious connection between the imperative of highway safety" and sobriety checkpoints existed. *Edmond*, 531 U.S. at 39. The Court acknowledged the severe problem that drugs pose to society, but noted that narcotics don't confront communities with the immediate threat to highway safety as that of a drunken driver. *Id.* at 43.

[33] *Id.* at 41-42. The Court declared that it had "never approved a checkpoint program whose primary purpose was to detect evidence of ordinary criminal wrongdoing." *Id.* at 41. The Court noted that in *Prouse* an attempt to justify the discretionary stop under the purpose of "general interest in crime control" was rejected. *Id.* The Court also rejected the petitioners' claim that the narcotics checkpoints "had the same ultimate purpose of arresting those suspected of committing crimes" as the roadblocks in *Martinez-Fuerte* and *Sitz*. *Id.* at 42. The Court explained that by allowing law enforcement to erect roadblocks for such a general purpose as crime control, "there would be little check on the ability of the authorities to construct roadblocks for almost any conceivable law enforcement purpose." *Edmond*, 531 U.S. at 42.

The Court specifically expressed no view as to whether police forces could erect checkpoints with the primary purpose of checking licenses and registration, with a secondary purpose of drug interdiction. *Id.* at 47 n.2. The Court explained, however, that general law enforcement roadblocks could be constitutional if erected "to thwart an imminent terrorist attack or to catch a dangerous criminal who is likely to flee by way of a particular route." *Id.*

Finally, the Court considered the petitioners' argument that precedent prohibited an inquiry into the purposes behind the roadblock program.[34] The Court agreed that prior cases precluded inquiry into a law enforcement officer's intentions, but decided that a determination of the purpose behind a roadblock program was appropriate.[35]

B. Justice Rehnquist's Dissenting Opinion

Justice Rehnquist dissented in the *Edmond* decision and found little practical difference between checkpoints organized for drug interdiction and the checkpoints conducted in *Martinez-Fuerte* and *Sitz*.[36] Justice Rehnquist found the majority's distinction between roadblocks used for a specific purpose and those used in general law enforcement to be less than compelling.[37] Justice Rehnquist argued that the "special needs" doc-

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[34] *Id.* at 45. The petitioners cited *Whren* and *Bond* in this section of their argument before the Court. *Id.*

[35] *Id.* at 45-46. In holding that the subjective intent of officers was irrelevant in determining the constitutionality of an objectively justifiable search, the Court "expressly distinguished cases where [it] had addressed the validity of searches conducted in the absence of probable cause." *Id.* at 45. The Court stated that "cases dealing with intrusions that occur pursuant to a general scheme absent individualized suspicion have often required an inquiry into purpose at the programmatic level." *Id.* at 46.

[36] *Edmond*, 531 U.S. at 50 (Rehnquist, C.J., dissenting). Chief Justice Rehnquist was joined in his dissent by Justice Thomas, and joined by Justice Scalia as to Part I. *Id.* at 48 (Rehnquist, C.J., dissenting). Chief Justice Rehnquist argued that the only difference between the checkpoint in *Sitz* and the one at issue here is the presence of a drug-sniffing dog. *Id.* at 52 (Rehnquist, C.J., dissenting).

[37] *Id.* at 50-51 (Rehnquist, C.J., dissenting). The dissent noted that checking driver's licenses and registration, along with getting impaired drivers off the road, were also listed purposes of the roadblock program. *Id.* at 51 (Rehnquist, C.J., dissenting). Chief Justice Rehnquist declared "it would be speculative to conclude . . . that petitioners would not have operated these roadblocks but for the State's interest in interdicting drugs." *Id.* (Rehnquist, C.J., dissenting). The valid reasons for operating these checkpoints, according to Chief Justice Rehnquist, made the majority's focus on drug interdiction irrelevant. *Id.* (Rehnquist, C.J., dissenting). The dissent noted that the city had proven the effectiveness of the program, submitting that 4.2 percent of the motorists stopped at the *Edmond* checkpoint were arrested for reasons unrelated to drugs. *Edmond*, 531 U.S. at 53 n.5 (Rehnquist, C.J., dissenting). Chief Justice Rehnquist argued that the primary purpose test "is ill suited to brief roadblock seizures, where we have consis-

trine was not applicable to the facts in this case, as the privacy expectation of a motorist is different from that of a person sitting in his home.[38] Justice Rehnquist criticized the majority's decision, lamenting that the decision had opened the door to litigation over the purpose of seizures at roadblocks.[39]

C. *Justice Thomas's Dissenting Opinion*

Justice Thomas dissented and found that, given precedent, the majority should have held that the checkpoint program presented to the Court was constitutional.[40] Justice Thomas expressed doubt as to the constitutionality of precedent, arguing that the Framers probably would have considered random stops of people not suspected of unlawful acts to be unreasonable.[41]

IV. DISCUSSION

In *City of Indianapolis v. Edmond*, the Supreme Court strengthened the Fourth Amendment protections against unreasonable searches and seizures as they are applied to checkpoint seizures of automobiles.[42] The Court focused more on

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tently looked at 'the scope of the stop' in assessing a program's constitutionality." *Id.* at 53 (Rehnquist, C.J., dissenting).

[38] *Id.* at 54-55 (Rehnquist, C.J., dissenting). Chief Justice Rehnquist argued that the brief seizure of an automobile at a roadblock is hardly comparable to an intrusive search of the home. *Id.* at 55 (Rehnquist, C.J., dissenting). The dissent explained that the *Brown* test should be applied to automobile seizures while the "special needs" doctrine should be reserved for searches of the home and person. *Id.* (Rehnquist, C.J., dissenting).

[39] *Id.* (Rehnquist, C.J., dissenting). The dissent asserted that according to the majority's rationale in this decision, the seizures upheld in *Martinez-Fuerte* and *Sitz* can be challenged on purpose grounds. *Id.* (Rehnquist, C.J., dissenting).

[40] *Id.* at 56 (Thomas, J., dissenting). Justice Thomas referred to the Court's decisions in *Sitz* and *Martinez-Fuerte*. *Id.* (Thomas, J., dissenting).

[41] *Edmond*, 531 U.S. at 56 (Thomas, J., dissenting). Justice Thomas noted, however, that the Court was not briefed on the proposition of overruling precedent. *Id.* (Thomas, J., dissenting). Justice Thomas, according to the reasons given by Chief Justice Rehnquist, believed *Sitz* and *Martinez-Fuerte* controlled, and therefore cast his vote with the dissent. *Id.* (Thomas, J., dissenting).

[42] *See supra* notes 21, 33 and accompanying text. *Edmond* provided motorists challenging checkpoints with an additional Fourth Amendment weapon: an inquiry

the purpose of law enforcement checkpoints and less on the effectiveness of roadblocks in illuminating any possible unlawful activity.[43] The Court provided guidance to police departments regarding situations in which individualized suspicion is not needed to make a lawful stop.[44]

By delving into the purpose of the checkpoint at issue in *Edmond*, the Court has exposed itself to criticism for making artificial distinctions between legal and illegal roadblocks.[45] The Court has also opened the door to litigation filed by motorists questioning the "real" purpose behind roadblocks purportedly erected for valid reasons.[46] The practical implications of *Edmond* are limited, however, judging from the importance the majority gave to the stipulation that the primary purpose of the checkpoint was drug interdiction.[47]

The decision in *Edmond* has given motorists greater freedom from the inconveniences of police checkpoints.[48] Although the politics and beliefs of future justices will decide how this decision ultimately fares, the solid six-justice majori-

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into the purpose behind checkpoint operations. *See supra* note 33 and accompanying text.

[43] *See supra* notes 23, 33, 37 and accompanying text. The Court's reliance on the overbroad purpose of the checkpoints as a reason to declare them unconstitutional was in marked contrast to the rationale in previous decisions to determine constitutionality based on "the scope of the stop." *See supra* note 37 and accompanying test.

[44] *See supra* notes 14, 16, 21, 24, 32, 33 and accompanying text. Aside from sobriety checks and license and registration stops, the Court noted that general law enforcement checkpoints might be appropriate during emergencies. *See supra* note 33 and accompanying text.

[45] *See supra* notes 21, 37 and accompanying text. Future plaintiffs will need to offer evidence concerning the primary and secondary purposes of roadblocks. *See supra* notes 14, 21, 33 and accompanying text.

[46] *See supra* notes 21, 39 and accompanying text. However, the new focus on purpose will operate as an additional safeguard against random and unjustified roadblocks. *See supra* note 24 and accompanying text.

[47] *See supra* notes 29, 33 and accompanying text. The checkpoint was identical to the one at issue in *Sitz*, except for the presence of a drug dog and the advertised purpose of drug-interdiction. *See supra* note 36 and accompanying text.

[48] *See supra* notes 14, 21, 24 and accompanying text. The restoration of Fourth Amendment rights comes after some scholars argued that the *Sitz* decision demonstrated a willingness on the part of the Court to abdicate its powers of judicial review in the Fourth Amendment arena. *See supra* note 24 and accompanying text.

ty in *Edmond* indicates that the Court will continue to block attempts by law enforcement groups to expand their ability to stop vehicles without probable cause, and continue to protect the Fourth Amendment rights of motorists.[49]

V. CONCLUSION

City of Indianapolis v. Edmond seemingly limits the ability of law enforcement agencies to employ checkpoints as a weapon in the war on crime. As a practical matter, however, the Court's decision will have little effect on law enforcement checkpoint procedures. In *Edmond*, the Supreme Court reconfigured the balancing test used in previous decisions by instituting a threshold inquiry into the government's interest in erecting particular checkpoints. The effect of altering the roadblock test will be to place as much emphasis in future litigation on the government's reasons for operating checkpoints as on the manner in which the roadblocks are conducted. Police departments may erect roadblocks with the stated purpose of conducting sobriety checks, but actually operate the checkpoints with the hopes of detecting other criminal activity. Nevertheless, *Edmond* stemmed the tide of decisions giving broad authority to law enforcement to stop motorists at checkpoints and placed local governments on notice that their interest in crime control does not supercede the Fourth Amendment rights of citizens.

John D. Shaw

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[49] *See supra* notes 10, 14, 21, 33 and accompanying text. It must be remembered that since the Court did not rule on sobriety checkpoints orchestrated with a secondary purpose of drug interdiction, law enforcement agencies have a sizable loophole through which they can circumvent the holding in *Edmond*. *See supra* note 33 and accompanying text.

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